THE CAPITAL MARKET OF INDIA

By the same author

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THE CAPITAL MARKET OF INDIA

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PREFACE

This book is based on three lectures, which I delivered extempore, in November 1958, at the Indian Statistical Institute, Calcutta. Some of the people who listened to the lectures suggested to me to write them down for publication. In fact, many years before I gave the lectures at the Statistical Institute, I had an idea of bringing out a publication of this nature. In early 1950, when I was on the staff of the International Monetary Fund, I prepared a paper entitled *Financial Institutions of India with Special Reference to the Mobilisation of Domestic Resources for Development*, for the use of the Economic Commission for Asia and the Far East. I had hoped to expand that paper into a book but I did nothing in that direction for many years. I must thank the authorities of the Indian Statistical Institute and also Professor K. B. Madhava, my teacher and a Vice-Chairman of the Institute, for having given me an opportunity to fulfil an earlier wish of mine.

I should like to make it clear that this book is mainly a *factual* one, intended to outline the working of the Indian capital market, which is by no means under-developed, for the benefit of the general reader, though I hope that the research student too would find it useful. In the last few years, many developments have taken place in the Indian capital market and much data have become available. I should think that many foreigners (and Indian students of the subject too) have felt the need for a single source wherein all the developments and statistical data could be got. I have been keen to present as much of statistical data as possible, having in mind in particular the audience I addressed at Calcutta. I hope that the data are sufficient for the reader to form his own judgment on the constitution and functioning of the Indian capital market. This is not to say that I have refrained from making such comments and criticisms as I considered

appropriate. I should be quite satisfied if it is regarded as a *useful introduction* to the study of the Indian capital market. The writing of this book has been strenuous, since ever so many facts and figures have had to be checked, and I hope that there are no major inaccuracies.

It is now my pleasant duty to express my thanks to the numerous friends who have helped me in various ways in preparing this book. My greatest obligation is to the group of young friends, comprising P. S. Mirza, K. G. Kurup, K. M. Hanifa, M. S. Doreswamy, Y S. Kedari and A. Raman, whose assistance has been both generous and spontaneous. I have also received valuable comments and suggestions from a number of friends, Sarvashri H. T. Parekh, K. N. R. Ramanujam, T. K. Ramasubramaniam, M. D. Bhat, V. V. Bhatt, S. G. Madiman, P. S. Nadkarni, K. Madhava Das and P. D. Ojha, who have read one or two chapters each. B. R. Tara, S N. Leela and K. S. Vasudevan too have been of help. B. S. Doraswamy has helped in a unique way, by constantly putting gentle pressure on me to complete the manuscript and by generally keeping me in good cheer by his warm friendship and hospitality. I also owe much to P. R. Brahmanand, the eminent young economist (who is generous enough not to have forgotten my having been a teacher of his at the University of Mysore); besides giving me many valuable suggestions, he arranged for the publication of this. He could not have secured for me a more efficient and considerate publishing house than that of Vora & Co., Publishers Pvt. Ltd. whose director, Shri M. K. Vora, has taken much trouble to bring out the publication neatly and expeditiously, in which task he was ably assisted by the Sirur Printing Press.

Finally, I wish to place on record that the atmosphere in the institution where I work is congenial for research and I would like to express my gratitude to its authorities for giving me permission to publish this. I should like it to make it clear that the views that have been expressed in this book are entirely my own and should not in any way be associated with the institution where I am working.

27, Bank House,
BOMBAY-1.
March 3, 1960.

S. L. N. SIMHA

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Note: In using the tables, the following general information may be noted.

The Indian financial year is from April 1 to March 31. Thus, 1958-59 means the year from April 1, 1958 to March 31, 1959. The Currency unit of the Indian Union is the Rupee. The abbreviation for rupees is 'Rs.' A Rupee is equivalent to 21 U.S. cents or 1 sh. 6 d. sterling. A crore=100 lakhs=10 million. Thus, Rs. 1 crore is equal to U.S. $2.1 million or £750,000 sterling.

The national income of India (at 1948-49 prices) is provisionally estimated at Rs. 11,570 crores for the year 1958-59, the estimate of *per capita* income for that year being Rs. 291.

Chapter 1

INTRODUCTION

Capital market is an extremely fascinating subject. An efficient capital market is an indispensable pre-requisite to economic development. The capital market is essentially an institution of a free economy and the subject is of considerable importance to us in India although we have embarked on the establishment of what is stated to be a socialist pattern of society. The precise nature of this Indian brand of socialism is far from clear and in any case for many years to come the private sector in India will have considerable scope for expansion. It is true that over the years, so far as new investment goes, the public sector is expected to account for a rising share but as far as one can foresee the private sector will continue to have a large sphere of operations. In fact, even as regards the resources for the public sector, the capital market has a rather important role to play since, according to the declared intentions of the present Government, our planning is largely a democratic one, operating primarily through the market mechanism, although one may keep an open mind on the compatibility of planning and democracy. The Indian capital market has made substantial progress during the post-Independence period and it has shown resilience. It should be emphasised at the outset that the Indian capital market, like the Indian money market, is by no means under-developed. As a matter of fact, the organisation of the Indian capital market does not compare unfavourably with that of some of even the developed countries, though obviously much more requires to be accomplished.

Fundamentally, the capital market is not different from any other market. The market mechanism is essentially called for because of the fact that we have an exchange economy with specialisation of functions. In the present day world, to a not inconsiderable extent, the people who initiate investment activity do not have funds for the purpose while there are also people who save

but who have no desire to utilise their savings directly for investment activity in the sense of establishing a factory or any other business enterprise. Hence the need for a market mechanism which facilitates the transfer of funds from those who have to those who need. The commodity that is dealt with in the capital market is long-term money, that is, money which is either lent for long periods or is invested more or less perpetually. A business enterprise requires money for two purposes: (i) for the purchase of capital equipment and other fixed assets and (ii) for the holding of stocks of raw materials and finished goods and also for making payment of wages etc. The former requirement is referred to as fixed capital or long-term capital, and the market for the provision of long-term funds is the capital market. The market for short-term money, that is, the use of money for a short period, is called the money market proper, commercial banks generally constituting the most important source of short-term funds. One might have a fruitless debate as to what is 'long' period and what is 'short' period. International convention is to regard any period longer than a year as long-term though it is also customary to divide the long-term period itself into medium-term (say upto 5-7 years) and long-term proper. It should, however, be pointed out that to some extent there is over-lapping between the money market proper and the capital market. The same institutions often participate in the activities of the two markets and there is flow of funds between the two markets. The capital market thus refers to all the facilities and the institutional arrangements for the borrowing and the loaning of long-term funds. It is hardly necessary to add that capital market has nothing to do with capital *goods*. It is concerned with the raising of *money* capital.

It was mentioned earlier that basically the capital market is very much like any other market. There are various sources of supply and demand. There are variations in supply and demand, the variations being cyclical rather than seasonal as in the case of money market. Just as the price is the heart of a commodity market, the price for the use of money, or what is called the rate of interest, is the heart of capital market. Further, even as in the case of commodities where there is no single perfect market, the capital market is not a completely homogeneous one, though money is the most standardised commodity. We have a number

of markets, corresponding to the sub-markets in any commodity, based on different grades but they are all inter-related, loosely in some cases and closely in others. We have, for instance, the market for government securities; we have the market for debentures; then again we have the market for long-term agricultural credit. Consequently there is no such thing as a single rate of interest; we have on the other hand a pattern or complex of long-term rates. Corresponding to regional and cyclical variations in demand and supply, the rates of interest also vary.

As in the case of commodities, a marketing organisation, comprising various intermediaries, is required to transfer funds from the savers to those who require them for investment. The intermediaries are the issuing and underwriting agencies, finance and stock brokers and institutional agencies such as life insurance companies, investment trusts and finance corporations. Since money is the most standardised commodity, imperishable and with large value in small bulk, the physical part of the marketing organisation is different from that of other commodities. There are no problems of warehousing, physical testing of quality, grading and transport. Also, unlike commodities which are consumed away, there is secondary trading all the time in the securities (shares and debentures), which are issued by those receiving the funds from investors.

The analogy between the capital market and the commodity market can be carried further. In the case of many commodities the sources of supply and demand are not purely domestic; exports and imports take place on varying scales. In the case of capital also movements across the border occur though such movements are now subject to many restrictions and are much smaller in magnitude in respect of private capital than it used to be a quarter of a century ago, even as the flow of commodities is not as free as it used to be before. It would be beyond the scope of this book to enter into a detailed discussion of the reasons for this diminished flow. For one thing, the developed countries, which are the source of supply, have themselves required large sums of capital for defence, war and post-war reconstruction and other investment purposes. For another, the underdeveloped countries, which in many cases have since attained political free-

dom, have been chary of receiving foreign private capital because of fears of 'exploitation' and even endangerment to their recently won freedom. Besides, in many countries there has been increasing tendency to adopt economic policies which, while they may be eminently justified from the individual country's point of view, render investment in these countries unattractive to foreigners. Recently, however, because of the urgency to proceed with economic development and the serious drains on the exchange reserves, there has been a better appreciation of the need to create a proper climate for foreign capital to come in. At the same time, imaginative action is being contemplated in the developed countries to expand the flow of capital to the underdeveloped areas. Even so, it is doubtful if private capital would be forthcoming in any substantial measure to the underdeveloped regions in general. Between the developed countries themselves the flow of private capital has been gathering momentum in recent years. For the underdeveloped countries the main source of capital has been and is likely to be international institutions, the World Bank in particular, and foreign governments.

Sources of Supply and Demand

The demand for capital comes from various sources, but predominantly from the manufacturing group. In underdeveloped countries like India, in view of its comparatively stagnant nature, agriculture is not much of a source of demand for capital. Further, in view of the small scale of agricultural operations, the demand for capital is met largely from the unorganised sector, that is, from individuals and to a small but growing extent from the co-operative institutions. In most countries, the Government constitutes an important source of demand for funds. This would be for defence purposes or for social and economic development. In many underdeveloped economies, however, the government's draft on the capital market is largely for the purpose of economic development; in many of these the extent of State participation in economic development is of substantial dimensions. The government has been investing not only on such economic overheads as transport, irrigation and power development but on basic and sometimes even consumer goods industries. Therefore, substantial sums are required from the capital market. In our own coun-

try we have embarked on a bold programme of economic development with a substantial volume of Government investment. In the First Plan period, out of a total investment of about Rs. 3,100 crores, Government investment was put at about 50 per cent. In the Second Plan, out of a total estimated investment of Rs. 6,200 crores, the share of the Government sector was expected to be about 60 per cent, but recent data indicate that the share may not be larger than 50 per cent. So far as the organised industry goes, investment in the private sector may turn out to be larger than that in the public sector. While the share of Government in total investment may rise, the magnitude of investment effort in the private sector will be large and hence the demand for capital from this sector will be considerable.

As regards the sources of supply of funds for the capital market, one should notice the growing importance of institutional media in India, as all the world over. So far as *equity* capital goes, individual investors still probably dominate. There is a great deal of internal financing done by the corporate sector, though it may not be as high as in a country like the U.S.A. Such saving and investment, which take place outside the capital market, is not an unmixed blessing beyond a point. Among the institutional investors, banks form an important constituent but their investments are largely in Government securities and to some extent in debentures. Life insurance companies, which have now been nationalised to form a single institution, namely, the Life Insurance Corporation of India, are also of growing importance in the capital market, though the major portion of their investments is in Government securities. Provident funds are becoming a very important media of saving, but their investments too are mostly in Government securities, Government small savings and other trustee securities. The Government itself provides some financial assistance to industry through subscription to ordinary and preference capital as well as debentures and also through direct loans, though on the whole assistance of this sort is marginal in character except perhaps in regard to shipping where it is substantial. There are also special institutions, in the

setting up of which the Government and the Reserve Bank of India have played a significant part, for the provision of capital to the private sector, mainly in the form of *loan* assistance. These include the Industrial Finance Corporation of India, the State Financial Corporations and the Refinance Corporation for Industry. Besides, with the assistance of World Bank and some foreign banks, another institution, namely, the Industrial Credit and Investment Corporation of India, was set up in 1955. The World Bank itself has provided assistance to the private sector, especially to the steel industry. The magnitude of external private capital coming into the country has so far been small, but the prospects now appear to be bright.

We have neither comprehensive nor up-to-date estimates of saving in India. Recently, the National Council of Applied Economic Research undertook a detailed project on this subject. Dr. V. V. Bhatt of the Reserve Bank of India has also made a valuable pioneering effort to estimate saving in India during the seven-year period 1950-57.* According to him, the ratio of saving to national income during this period, beginning with 1950-51, was as under: 7.1, 5.9, 6.0, 6.1, 7.5, 7.6 and 7.5 per cent. What is of greater significance, however, is the *marginal* saving-income ratio. Here the difficulty is the selection of a base year; we can take two years, namely, 1950-51, the pre-First Plan year, and 1952-53, the base year for many other series. The marginal saving-income ratio was 9.3 per cent in the six-year period 1951-57 and 16.7 per cent in the four-year period 1953-57. Rough as these estimates are, they give an encouraging picture of the saving effort, though in recent years saving has lagged considerably behind investment growth, the gap being financed by the use of foreign exchange reserves and external assistance. The current saving/national income ratio is estimated at about 8 per cent and the investment/national income ratio at about 11 per cent, the Planning Commission's estimate of the latter ratio for 1950-51 being about 5 per cent.

* Vide his paper *Savings and Capital Formation*, in the journal "Economic Development and Cultural Change", April 1959.

Factors Influencing Saving and Investment

Saving and investment depend upon the people's ability as well as willingness. Low per capita incomes certainly render it difficult to save and for this reason in a country like ours small saving schemes occupy a strategic place in the mobilisation of saving. Political stability, moderation and continuity in respect of Government's economic policies, fair prospects of profit-earning and reasonable protection to investors are some of the important pre-requisites to high levels of saving and investment. In these respects it would appear that conditions in India have on the whole been favourable so far. We have of course embarked on the establishment of a socialist pattern of society but so far it does not appear to have had any unfavourable effect on saving and investment in the private sector. In fact, in the last few years, the growth of investment in the organised sector has been truly phenomenal and it has had to be restrained because of the balance of payments difficulties. The pattern of taxation—especially of direct taxation of individuals as well as corporations—is also generally mentioned as having an important influence on the rate of saving and investment, the general theory being the smaller the tax burden, the higher the rate of growth of saving and investment. Surprisingly, the evidence all the world over is to the contrary. Practically in all countries, over the years, taxation has been rising either for defence purposes or for the provision of social services but it is also a fact that everywhere the rate of growth of investment has been quite rapid. In fact, in many countries the Government and the monetary authorities have had to restrain the tempo of investment on account of the growth of inflationary pressures. The influences that govern investment decisions are complex and while pecuniary considerations are undoubtedly of considerable importance, they do not by any means constitute the sole influence. The desire to do something creative and to be at the helm of influence, power and patronage are also of vital importance. This is not to say that the tax system in India or in any other country does not admit of improvements from the point of view of capital formation.

Investment in Bullion

In India, much more than in under-developed countries generally, a part of the saving is used for the purchase of precious metals. Sometime ago all available statistics regarding the holdings of gold and silver in India were put together in an article in the *Reserve Bank of India Bulletin* (April 1958). These estimates indicate that gold holdings in India are a little over 100 million ounces, the corresponding figure for silver being of the order of 4,200 million ounces. At world prices, the value of these holdings amounts, respectively, to Rs. 1,750 crores and Rs. 1,800 crores. These are no doubt big sums but they represent the cumulative position over centuries. The annual absorption of precious metals in the last 7-8 years would appear to have been, on the average, about 4-5 per cent of total saving and less than one-third of one per cent of national income. In other words, the popular impression, especially abroad, that the hoarding of bullion in India is of very large dimensions, is not correct.

It should also be noted that in India the bulk of the precious metals is held in the form of ornaments and utensils for daily use (in the case of silver) and not as bullion. In other words, to a significant extent, bullion is in the nature of a durable consumer article. The motives for the purchase of precious metals are complex, being associated with social, political and economic factors. It is also significant that in recent years even in some of the highly economically developed countries, France in particular, there has been large-scale private hoarding of gold. The hoarding of precious metals is not *per se* such a heinous crime as many would have us believe. Government policies themselves, especially pursuit of unsound financial policies, such as large-scale deficit financing, provide a favourable environment for the hoarding of precious metals. Low literacy, lack of banking facilities, political disturbances over the centuries and religious practices have constituted the main factors for people's preference for gold and silver in India. With the spread of literacy and education and the development of banking facilities, undoubtedly precious metals have been losing their attraction but this is a very slow process. Government has banned imports of gold from March 1947 but it is known that supplies have been smuggled from abroad. Imports

of silver too have been prohibited from the above date, though since May 1956 imports of silver coins from Tibet have been permitted. In the context of the development Plans we have undertaken, investment in gold, which is produced in India in very little quantity (less than 200,000 ounces) in relation to the demand, means misuse of foreign exchange, and this we can ill afford. A campaign to impress this on the Indian public is urgently called for. In early May 1959, an important step was taken to check smuggling of gold, by issuing a special series of Indian currency for circulation abroad, especially in the Persian Gulf territories, where the Indian rupee circulates freely. This has put an end to the automatic conversion into sterling of the Indian notes illegally taken out to finance smuggling of gold, etc. The difficulties of weaning the Indian public away from precious metals are many but the job should be done.

Measures to Protect the Investor

The growth of investment habit also depends to a considerable extent on the various statutory measures to protect the investor. It should be remembered that in the case of the funds which pass through the capital market the owner parts with the funds either permanently (in the case of investment in shares) or for very long periods (in the case of investment in debentures or purchase of life insurance policies). It is, therefore, of the utmost importance that there is a fair amount of security for the funds so invested. In this respect also India is favourably situated. There is a fairly adequate legislative framework for the protection of investors. These measures comprise the Companies Act, the Securities Contracts (Regulation) Act, the Insurance Act and the Provident Funds Act and Rules. The Insurance Act and the Provident Funds Act mainly regulate the investment of funds. In addition to these there is also the Capital Issues (Control) Act, the broad object of which is to regulate the flow of funds in accordance with the general pattern of investment priorities decided upon by Government. In the year 1957-58, the Government had also initiated control over the use of reserves of the joint stock companies but this was withdrawn next year. Any way, the measure of Government con-

trol over the capital market is substantial in India. This is not surprising having regard to the fact that India has embarked on State planning, the goal being the establishment of a socialist society, though many of the legislative measures to protect the investor and regulate the capital market have been there for many years and have nothing to do with Government planning or socialist pattern. As a matter of fact, it is interesting to note that in a country like the United States, which is wedded to the doctrine of free enterprise, the legislative framework to protect the investor and to regulate the capital market is as comprehensive as in India and perhaps more rigorous in certain directions. In India, the Companies Act has been in force from 1913. It underwent major changes in 1936 when the Act was amended. This was replaced by almost a new legislation in 1956; the 1956 legislation is also being amended. The Securities Contracts (Regulation) Act, which regulates trading in stocks and shares, is a comparatively new enactment, having been passed in 1956. Legislation to regulate the working of the life insurance companies in a comprehensive way has been there from the year 1938. Since January 1956 the life insurance business has been nationalised though it is now administered by an autonomous board under the broad control of the Central Government. The Capital Issues Regulation has been in force from May 1943, first in the form of a Defence of India Regulation and subsequently as an Act of Parliament. Although, strictly speaking, commercial banks form, essentially, constituents of the money market proper, the regulation of commercial banks, through the Banking Companies Act, may also be briefly referred to, since the growth of banking habit is so vital to the growth of saving and investment. The main features of these enactments are described in Chapter 2.

The plan of the rest of this book is as under: The growth of the capital market in statistical terms—growth of joint stock companies, expansion of life insurance business, the trend of post office savings bank deposits and other schemes of small savings and the growth of public debt will be described in Chapter 3. In Chapter 4, the constituents of the capital market are described in a general way and thereafter there is a detailed discussion of each of them—managing agents, banks, the various finance corpo-

rations and stock exchanges. The special problems of small scale industries and agriculture in meeting their capital requirements are also briefly considered. A chapter has also been devoted to the provision of Government finance for industry in the private sector. This is followed by a brief discussion of the pattern of interest rates in India. In the concluding chapter an attempt has been made to assess the adequacy of the Indian capital market machinery for the task of rapid development which the country has embarked upon. Some important aspects of the subject of economic growth, such as mobilisation of resources, the role of Government, deficit financing, foreign aid and monetary policy are also referred to very briefly.

Chapter 2

LEGISLATIVE PROTECTION TO INVESTORS

(a) COMPANIES ACT

The Indian Companies Act, 1956, which came into force on April 1, 1956, marks an important stage in the development of Company Law in India.* It is a comprehensive measure aimed at consolidating and amending the previous law relating to companies, largely in conformity with the recommendations made by the Company Law Committee, modified in a few particulars by the views expressed on these recommendations by the general public and Parliament.

The importance of a comprehensive statute to regulate the formation and working of joint stock companies cannot be exaggerated. This form of business organisation has become indispensable for the growth of modern industry. The requirements of capital for running a modern industrial unit are generally such as are beyond the resources of an individual or a partnership. Besides, there is always the risk of large losses, which cannot always be shouldered by one or a few. For these reasons, a joint stock company, which pools the resources of a large number of people, whose liability is limited to the extent of their contribution to the capital of the company (whereas in the case of an individual or partnership business liabilities have to be met from assets outside the business) is much the most suitable form of business organisation. While the resources are contributed by quite a large number of people — the shareholders — the management can only be done by a small number of persons, the Directors, even as in a democracy, while there are millions of voters and hundreds of legislators, the Government is run by a few ministers constituting the cabinet. In theory, the shareholders

* The description of the Companies Act is largely extracted from the Summary appearing in the Reserve Bank of India's *Report on Currency and Finance* for the year 1955-56.

are supposed to take care of their interests themselves, but in practice, owing to their being large in number, scattered over the whole country and in some cases across the national frontiers, and on account of the ignorance of law on the part of many and their general apathy, the Government has responsibility for exercising some broad supervision, in order to safeguard the funds of the investors. Hence the importance of company legislation in all the countries.

The basic problem of company legislation is this: to what extent is it possible to adjust the structure and methods of the corporate form of business management, with a view to weaving an integrated pattern of relationship as between promoters, investors and the management so as to secure certain objectives? These objectives include: (1) an increase in the efficiency of corporate business, (2) reconciling managerial efficiency with legitimate rights of investors, (3) safeguarding interests of creditors and other partners in production and distribution, and (4) attainment of ultimate ends of social policy, including labour relations. With these objectives as the background, the salient features of the Companies Act, 1956, may be summarised under certain broad categories, viz., (1) company promotion, formation and capital structure, (2) company meetings and procedures, (3) presentation of company accounts; powers and duties of auditors, (4) inspection and investigation of the affairs of companies, (5) formation of Board of Directors; powers and duties of directors and (6) terms and conditions of the appointment of managing agents, their powers and duties.*

The new Act makes considerable changes in the matter of prospectuses, allotment of shares, terms and conditions on which companies may be floated and the share structure of companies. The particulars that a company is required to disclose in its prospectus have been considerably increased to place the investors in a much better position than they had been earlier to assess the intrinsic merit of a new issue. Disclosure of all essential

* The system of managing agents, which is explained in detail in Chapter 4, is peculiar to India. The managing agents, who may be individuals, firms, private limited companies or public limited companies, play an important role in all spheres of corporate enterprise, namely, formation, raising of capital and day-to-day management.

information is also the first step towards safeguarding the interests of prospective investors and ensuring sound company floatation, and has the effect of impressing on the directors and others concerned that the promotion of a company requires higher degree of vigilance than had hitherto been required of them.

As regards the *capital structure* of a company, the most important change is the provision laying down that the share capital of companies should be only of two kinds, viz. equity capital and preference capital, and that the voting rights on all matters should ordinarily be conferred only on the holders of equity capital. In the case of preference shareholders, only qualified voting rights have been given, e.g., such rights may be exercised when the interests of the preference shareholders are adversely affected.

Unlike the old Act of 1913, the 1956 legislation precisely sets out the requirements as to *meetings* of companies and the procedure to be followed by them. A feature of the provisions is that they try to hold the scales even as between company management and shareholders in regard to exercise of their voting rights in company meetings. Two important changes of interest effected are: (i) abolition of the resolutions known as extra-ordinary resolutions under the old Act of 1913, so that now there are only two types of resolutions, ordinary and special and (ii) increase in the period of notice for general meetings from 14 to 21 days.

The new Act requires much greater information to be included in the *accounts*, so as to reveal the true financial position of a company and its state of affairs. These provisions are designed to promote sound financial practices by joint stock companies and also to ensure a higher standard of auditing of company accounts.

Investigation of the affairs of a company as provided for under the old Companies Act had attracted much adverse comment from the public. The new Act, therefore, greatly enlarges the powers of the Central Government and of shareholders to initiate investigations into the affairs of companies. In addition, the Central Government can also apply to a Court of Law for redress in cases where companies act in a manner prejudicial to

their interest or in a manner oppressive to any of its members. Power has also been taken to investigate the ownership of shares in a company in certain circumstances. Enlarged powers have also been given to inspectors to call for information not only from the company under investigation, but from related managing agency firm or companies under the management of the same managing agents.

The provisions of the new Act as well as the amendments to the provisions of the old Act which deal with *directors* are designed to ensure firstly, the constitution of an independent Board of Directors, assisted by representatives of both the management and the shareholders, without the dominance of the former over the latter; secondly, adequate exercise of control by directors over managing agents and thirdly, prevention of arbitrary exercise by directors of powers which they are entitled to exercise on behalf of the company. In view of the past experience, control is now imposed on the use of some of these powers, viz., the power to make loans, to enter into contracts and to borrow on behalf of the company. A limit is also placed on the number of directorships that a person can hold (namely 20), the intention being to ensure that adequate attention is paid to the affairs of the company by the directors. Other important provisions in the Act include: (1) specific approval by the company, in general body meeting, for appointment of sole selling agents by the Board of Directors and (2) power to Central Government to appoint not more than two persons, being members of the company, as directors for a period not exceeding three years, if a fairly big section of the shareholders complains of oppression and mismanagement. The intention is, however, to use these powers only in very exceptional cases.

The Act also contains a number of provisions aimed at putting a check on some unhealthy trends noticed in the management of companies in regard to appointment, re-appointment, remuneration, etc. of managing agents, directors, managing directors, etc.

With a view to preventing widespread abuses of the powers conferred on the *managing agents,* the provisions of the old Act relating to the terms and conditions of appointment of managing agents, their remuneration, powers of managing agents *vis-a-vis*

directors and duties of managing agents in regard to borrowing, loan contracts as well as purchases, have been tightened up. On an objective assessment of the present structural organisation of the trade and industry of the country and the obvious gaps in its institutional set-up, Government felt that managing agency should yet prove to be a potent instrument in moving the springs of private enterprise, if the system was cleansed of the abuses and malpractices which had disfigured its working in the past. Important provisions relating to managing agents include: (1) all existing managing agents will cease to hold office on August 15, 1960, provided, in the meantime, a managing agent has been re-appointed, for a fresh term, with the approval of the Central Government; (2) no person, firm or body corporate should be managing agent of more than 10 companies after August 15, 1960; (3) no managing agency agreement shall in future provide for agency being heritable or devisable by will; if such an agreement was already in existence on the date of the commencement of the new Act, the heir or devisee would be allowed to act as managing agent, provided the company satisfies the Central Government about his suitability. Special mention may be made of the new provision which empowers the Central Government to notify that no company engaged, whether wholly or in part, in any industry or business, to be specified in the notification, should have managing agents. The effect of such a notification will be that no company which did not have a managing agent on the date of the notification can appoint one subsequently and that a managing agent holding office on that date will cease to do so after three years from the date of the notification or on the 15th August, 1960, whichever is later.

The Act fixed the overall maximum *managerial remuneration* at 11 per cent of the net profits, while provisions have also been made fixing limits on the remuneration payable to each class of office-bearers mentioned with reference to the net profits of the company. The maximum remuneration to the managing agent was fixed at 10 per cent of net profits. But this has since been revised (see below).

The new Act has given recognition to the system of *secretaries and treasurers* and they will exercise much the same functions as managing agents but with certain differences.

The Indian Companies (Amendment) Act of 1951 provided for the setting up of a *Commission* of not more than 3 persons to advise Government in regard to exercise of powers conferred on them by that Act. The Advisory Commission has now been put on a permanent footing. The maximum membership has been raised to 5 to provide for adequate representation of different interests, while the scope of the Commission has been extended, requiring the Commission to advise on all matters referred to it and not only those required to be referred to the Commission under the 1951 Act. The advisory functions assigned to the Commission under the Act include, among others, changes in the management of companies, the appointment and re-appointment of directors, managing directors, managers, managing agency agreements, changes in the terms and conditions of their appointment, changes in the constitution of managing agency firms or companies, increases in the remuneration of directors, managing directors or the managing agents.

In May 1957, the Government of India set up an *ad hoc* committee under the chairmanship of Shri A. V. Viswanatha Sastri to suggest amendments to the Companies Act, 1956, with a view to (i) overcoming practical difficulties in its working and administration, (ii) removing drafting defects and obscurities and (iii) plugging loopholes and removing lacunae in the provisions of the Act so as to ensure better fulfilment of the purposes underlying the Act and also simplifying the form and structure of the law. The Committee submitted its report in November 1957 and an amending bill was introduced in Parliament on May 1, 1959.

Some of the proposals under the third category, namely, plugging loopholes, are as under: Any conversion of a public company into a private company would require prior and express approval of Government, in order to minimise evasion of restrictions placed on the management of public companies. The privileges and immunities of private companies are to be restricted. All dividends shall be distributed in cash and out of profits after provision for depreciation. Powers of inspection and investigation are to be enlarged. Cornering of shares is to be rendered more difficult; the Central Government can prohibit transfer of shares where it is undesirable in public interest. Regu-

lation of inter-company loans and investments is to be tightened. Donations to political parties should be disclosed. Restrictions are also to be placed on appointment of selling agents, so that managing agents may not circumvent the ceiling on managing agency remuneration. The amending bill does not contain anything about the remuneration of managing agents or continuance of the system. However, in October 1959, the Government announced the fixation of managing agency remuneration on a slab system, varying from 10 per cent on the first slab of profits of Rs. 10 lakhs or fraction thereof to 4 per cent above Rs. 1 crore; the corresponding percentages for Secretaries and Treasurers are 7½ per cent and 3 per cent. The Government have also decided that the term of office should ordinarily be 10 years when a company appoints managing agents or Secretaries and Treasurers for the first time and five years on re-appointment or successive appointments.

It is difficult to say what the effect of the Companies Act of 1956 has been on company formation. During the first year of its operation, viz., April 1, 1956 to March 31, 1957, there was a decrease in the number of companies registered as well as in their authorised capital, both public and private, but excluding Government companies. In 1957-58, the number of registrations as well as the authorised capital declined in the case of public limited companies but in respect of private limited companies there was a rise in both the items which was also the case in 1958-59. In 1958-59, the number of public limited companies registered a further decline but the amount of authorised capital recorded a slight rise over 1957-58. The decline in new registrations in respect of public limited companies should be partly attributed to the stringent provisions under the Act applicable to the public limited companies. The fall in the registration of companies in 1956-57 was no doubt partly due to uncertainties and apprehensions created by the new Act and partly due to rush for registration immediately before the commencement of the new Act. Company registration during the years 1957-59 should also be seen against the background of the radical changes in the tax system and the severe import cuts, following the serious drain on foreign exchange reserves from April 1956. On the whole, there is no evidence to indicate that the new Companies Act has

had a disincentive effect on company formation and expansion. As a matter of fact, in 1956 and 1957, the rate of investment in the private sector recorded a phenomenal rise. To the extent that irresponsible type of company formation has been checked, the objective of the new legislation has been realised. There is little doubt that in the long run the new legislation must help the growth of investors' confidence.

(b) REGULATION OF TRADING IN SECURITIES

Legislation was also passed in 1956 for the regulation of transactions in securities, the relevant Act being the Securities Contracts (Regulation) Act, 1956. The Companies Act is concerned with the formation, management and winding up of companies. While a company as an entity continues to perpetuity, so far as the owners of the companies go, that is the shareholders, it need not be so. As a matter of fact, one of the fundamental advantages of the joint stock company form of business organisation is that a shareholder can sell his ownership rights to someone else. This he may do either because he wants money for some personal expenditure or because he wants to divert his investment into other channels, including the holding of cash. In practice, purchases and sales of securities take place on a fairly large scale. In the result, in all countries with joint stock company form of business, markets for securities have developed. Some transactions, especially in securities of companies which are relatively small, take place in the unorganised or what is called the 'over the counter' market. But, by and large, the transactions take place under the auspices of an organised institution called the stock exchange. It should be pointed out at the very outset that the stock exchange is not a body that carries on transactions in shares. Rather it is in the nature of a club which provides facilities for members, the stockbrokers and jobbers, in a regulated way, to carry on transactions in shares. (See Chapter 8 for a detailed account of stock exchanges.) The regulation refers not merely to the promotion of the best interests of the members themselves but also those of the thousands and millions of investors who make their purchases and sales of securities through members of the stock exchanges.

The basic objectives of the regulation are to see that the market functions in such a way as to facilitate the establishment of proper prices without manipulations of any sort, to ensure that members honour their contracts properly and generally to protect the interests of the outside investors. It should be emphasised that it is not the business of the stock exchanges to interfere with the determination of prices, as a result of various forces operating on the side of supply and demand. In other words, the stock exchange does not fix prices as is erroneously believed in some quarters. However, now and then, manipulations are resorted to by big speculators, both non-members of the exchange and members. Apart from manipulations, which are by no means frequent, the source of instability is excessive speculation, that is, abnormal purchases or sales, based on either blind chance(called gambling) or on errors of optimism and pressimism. There is no doubt that it is extremely difficult to draw the line between speculation and gambling or between 'excessive' speculation and 'healthy' speculation, though indicators are not quite lacking for the purpose. Manipulations and excessive speculation inevitably widen the amplitude of fluctuations in stock prices. Violent fluctuations in prices of stocks and shares affect investment in securities adversely and thereby the growth of economy. They also affect the credit system, for speculation is, to some extent, encouraged by bank credit and when there is crash in prices the liquidity of banks will be weakened. Therefore, there is need for some kind of regulation. Since it is unlikely that the stock exchanges themselves will do an adequate job of regulation, statutory regulation has been regarded as necessary in many countries. Abroad, a very comprehensive regulatory statute is in force in the U.S.A., for about 25 years.

In India, regulation of stock exchanges on an all-India basis was absent till recently, except in a limited way, though efforts have been made in this direction from the beginning of the post-war period. In the State of Bombay there was a loose framework of legislation in respect of futures transactions in shares, in terms of the Bombay Securities Contracts Control Act, 1925. During World War II, legislation of an all-India character but of very limited scope, was attempted under the Defence of India Rule 94 C. Under this Rule, stock exchanges were prohibited

from permitting or affording facilities for forward contracts as well as carry-over (i.e. *budla*) business, but the general view is that the Rule was, by and large, ineffective. The aforesaid Rule lapsed in September 1946. Legislation of all-India type, however, was passed only in 1956 with the enactment of Securities Contracts (Regulation) Act, 1956. The enactment was preceded by a comprehensive examination of the subject by a number of committees including in particular a committee presided over by Shri A. D. Gorwala in 1951. The main features of the Securities Contracts (Regulation) Act may now be described.*

It should be emphasised that the Act provides for a general system and apparatus of control, without detailed or meticulous regulatory provisions relating to any specific matters. In particular, statutory provisions have not been made for those reforms in stock exchange trading methods and practices, e.g., relating to blank transfers,** *budlas,* etc. which have been the subject of much controversy in the past. Power has been taken in the Act to make or direct the making of suitable bye-laws to deal with them, as soon as conditions necessary for their introduction and enforcement have been created, and so detailed regulations on these subjects have been deliberately held over to be made at a later stage, in the light of the administrative and institutional changes which would be needed to deal effectively with the problems connected with them.

Broadly speaking, the Act applies to transactions other than *spot* delivery contracts. A spot delivery contract is defined as a contract which provides for the actual delivery of securities and the payment of a price therefor either on the same day as the date of the contract or on the next day, the actual period taken for the despatch of the securities or the remittance of money therefor through the post being excluded from the computation of the period mentioned above, if the parties to the contract do not reside in the same town or locality. The exemption of spot

* This part is almost a reproduction of parts of a note on the subject appearing in the *Reserve Bank of India Bulletin*, October 1956.

** A transfer deed, wherein the buyer's name is not entered or is left blank. The system of blank transfers is considered to encourage speculation as delivery becomes extremely simple and there is saving of stamp duty (see Chapter 8).

transactions is based on the premise that normally speculation of any significant dimensions cannot take place in spot transactions. However, power has been taken in the Act to regulate spot delivery contracts also, if Government regards it as desirable in the interest of trade or in the public interest. As regards contracts other than those for spot delivery, the regulation takes the form of either controlling the activities of stock exchanges in those areas or States where stock exchanges operate, or through a system of licensing of persons who deal in stocks and shares. In those areas where a recognised stock exchange operates, every contract which is entered into otherwise than *between* members of a recognised stock exchange in such State or area or *through* or *with* such member is illegal.

The Act permits only those stock exchanges to function which are recognised by the Central Government. For this purpose, each stock exchange is required to make an application in the prescribed manner to the Central Government. Recognition will be granted if the Central Government is satisfied (1) that the rules and bye-laws of the stock exchange applying for recognition are in conformity with such conditions as may be prescribed by Government to ensure fair dealing and to protect investors. The conditions may, among other things, relate to qualifications for membership of the exchange, representation on the exchange of the Central Government through not more than three nominees, the manner in which contracts shall be entered into and enforced as between members, and the maintenance of accounts of members and their audit by Chartered Accountants whenever such audit is required by the Central Government; (2) that the stock exchange is willing to comply with such other conditions (including conditions as to the number of members) which the Central Government, after consultation with the governing body of the stock exchange, may impose for the purpose of carrying out the objects of this Act and (3) that it would be in the interest of the trade and also in public interest to grant recognition (Section 4). The Central Government has been empowered to withdraw, by notification in the official gazette, the recognition granted to a stock exchange, in the interest of trade or in public interest, after giving the governing body of the exchange a written notice of the withdrawal, for the reasons stated therein, and

after giving an opportunity to the governing body to be heard in the matter.

Every recognised stock exchange is required to furnish to the Central Government such periodical returns relating to its affairs as may be prescribed. Every recognised stock exchange and every member thereof is also required to maintain and preserve for such periods not exceeding five years such records as the Government, after consultation with the stock exchange, may prescribe in the interest of trade or in public interest. Further, the Government is empowered (i) to call upon a recognised stock exchange or any member thereof to furnish such explanation or information as it may require relating to the affairs of a stock exchange or of any member in relation to the stock exchange and (ii) to appoint one or more persons to make an enquiry into the affairs of the governing body of a stock exchange or the affairs of any of its members in relation to the stock exchange and to submit a report to the Central Government. Recognised stock exchanges are also required to submit to the Central Government their annual reports which may contain such particulars as may be prescribed.

Any recognised stock exchange may, subject to the previous approval of the Central Government, make bye-laws for the regulation and control of contracts. These bye-laws may provide for, among other things, the opening and closing of markets and regulation of the hours of trade; a clearing house for the periodical settlement of contracts and differences thereunder, the delivery of and payment for securities, etc.; regulation or prohibition of blank transfers; regulation or prohibition of *budlas* or carry-over facilities; fixing, altering or postponing of settlement days; regulation of *taravani** (i.e. jobbing) business, the separation of the functions of jobbers and brokers; listing of securities on the stock exchange; method and procedure for the settlement of claims or disputes, including settlement by arbitration; emergencies in trade which may arise and exercise of powers in such emergencies, including the power to fix maximum and minimum

* A jobber is a member who always stands ready to buy or sell.

prices for securities; regulation of dealing by members for their own account, and limitation in exceptional circumstances of the volume of trading done by individual members.

While thus every recognised stock exchange is left free to make its bye-laws subject to the approval of the Central Government, power has been taken by the Government to make or amend bye-laws of recognised exchanges; however, before the Government could exercise this power, it is required to consult the governing body of the stock exchange and also to record the reasons for making or amending the bye-laws. It has been provided that in all such cases the bye-laws so made or amended should be published in the official gazette. Further, in order to deal with abnormal and extraordinary situations, which may develop from time to time, power has been taken under the Act to supersede the governing body, after giving an opportunity to that body to be heard in the matter, and to appoint in its place any person or persons to perform the functions of the governing body; and (ii) to suspend such of the business of a stock exchange under certain circumstances, for such period not exceeding seven days, as may be specified, in the interest of trade, or in public interest. The period of suspension can be extended from time to time, but after the governing body has been given an opportunity of being heard in the matter. Furthermore, in order to prevent undesirable speculation in specified securities, the Central Government may declare that transactions in such securities would be subject to such conditions as the Central Government may prescribe. Dealings in options are prohibited under the Act.

The Act also contains important provisions in respect of the listing of securities on a stock exchange, since listing is not only of great advantage to investors and to the company whose shares are listed but also provides a valuable indirect check and safeguard against manipulations. The Act empowers the Government to compel any public company to have its shares, bonds, debentures or other marketable securities admitted to dealings on a recognised stock exchange, by requiring it to fulfil any conditions that may be prescribed in this behalf by the stock exchange concerned. Under the Act, a right of appeal to Central Government is conferred on any public company which has been refused a

quotation of its shares, bonds, debentures, by a recognised stock exchange; the Central Government may vary or set aside the decision of a stock exchange.

It has already been mentioned that no direct provisions are contained in the Act to restrict the prevalence of blank transfers, but there is a provision to discourage blank transfers indirectly. Section 27 of the Act provides that it shall be lawful for a registered shareholder of a security to retain any dividend payable thereon, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee who claims the dividend lodges the security and other documents relating to the transfer for being registered in his name within 15 days of the date on which the dividend became due. This period may be extended in certain cases like the death of the transferee or loss of the transfer deed. The Joint Select Committee, which considered the question, expressed the view that the currency of blank transfers should be limited, by bye-laws, to a period not exceeding six months. The Committee did not, however, make any amendment to this effect. They suggested that Government as well as the stock exchange should take note of and give effect to it. The Minister for Revenue and Civil Expenditure, in the course of the debate on the measure in the Lok Sabha, stated that the Government would consult the stock exchanges and without hampering legitimate business in any way, try to make blank transfers non-existent beyond a period of six months.

All stock exchanges other than recognised stock exchanges are declared illegal. Without the previous sanction of the Central Government there should be no association of persons for organising a stock exchange.

In regard to the licensing of dealers and brokers in securities there are no detailed provisions. According to the Act, in any State or area to which Section 13 of the Act has not been applied —that is, outside the jurisdiction of recognised stock exchanges— the Central Government may notify that no person shall carry on business as a dealer in securities except under the authority of a licence granted by the Central Government in this behalf. This restriction does not, however, apply to dealings by or on behalf

of members of recognised stock exchanges. The Central Government has also the power to make detailed rules for the licensing of dealers in securities. The rules may provide for the manner in which applications may be made by dealers in securities for licences, the fee payable in respect thereof and the period of such licences, the conditions subject to which licences may be granted, including conditions relating to the forms which may be used in making contracts, the documents to be maintained by licensed dealers and the furnishing of periodical information to such authority as may be specified and the revocation of licences for breach of conditions.

It will be appropriate to close this account of the Securities Contracts (Regulation) Act, 1956, with the concluding observations of the then Finance Minister (Shri C. D. Deshmukh), while speaking in the Lok Sabha on his motion to refer the relevant Bill to a Joint Select Committee: "It is my hope that, in the fullness of time, when we have succeeded in building up an administrative set-up, strong and competent enough to discharge, with understanding, wisdom and vigour, the new duties and responsibilities entrusted to it, the two measures,* between them, will go far to create those basic conditions on which alone, I venture to think, the edifice of a sound and revitalised private sector can be built up, duly informed with the assumptions and postulates of our socio-economic policy, such as will enable it to play its dynamic role in the future pattern of society which we have chosen to adopt."

(c) LIFE INSURANCE LEGISLATION

Until January 1956, life insurance business was principally carried on by private companies. In view of the fact that life insurance business is a long-term contractual obligation, involving locking up of the saving of the public, statutory regulation was absolutely necessary. For this purpose, legislation was enacted as early as 1912 and major amendments were effected in 1938, following a detailed enquiry by a Committee under the chairmanship of Sir Cawasji Jehangir. The principal provisions of the legislation related to the investment of life funds and expense

* The other measure is the Companies Act, 1956.

ratios. The nationalisation of life insurance in 1956, however, indicates that statutory regulation was far from successful. This was probably due as much to the limitations of the statute as to its rather unsatisfactory enforcement. The nationalisation decision, which is in keeping with socialist traditions, was also taken with a view to achieving a marked spread of life insurance business, for mobilising maximum resources for the development plans on which the country has been engaged.

When life insurance was nationalised and various companies amalgamated into the Life Insurance Corporation of India in 1956, the idea was that the structure of regulation of life insurance management and investment was to remain, by and large, the same. For a time, however, there was some ambiguity regarding the application of the provisions of the Act relating to investment of the Corporation's funds. In August 1958, these ambiguities were set at rest by a clear enunciation of the policy of the Corporation by the Union Finance Minister. However, insofar as the Life Insurance Corporation is a nationalised institution and its directors are nominated by the Central Government, which has also the power of issuing directives to the Corporation, the various legislative provisions of the Act are not of fundamental significance as they would have been if life insurance management was in private hands.

The Life Insurance Corporation Act of 1956, under which the Life Insurance Corporation of India (LIC) was established, contains provisions for (i) application to the LIC, simultaneously with its establishment, of certain sections of the Insurance Act, 1938, and (ii) application by the Government of India of certain other sections of the Insurance Act also subject, however, to modifications after the commencement of the LIC Act. By a notification issued on August 23, 1958, by the Government of India, these sections have since been made applicable with certain modifications. Provisions of the Insurance Act, 1938, which were made applicable to the LIC along with its establishment, covered matters which were mostly of an administrative character, relating to the authority of the Controller of Insurance to call for information and reports, investigate and settle claims of small insurance policies, besides dealing with a

few undesirable practices such as grant of rebates. On the other hand, the provisions made applicable subsequently, with modifications in a few important respects, concerned more vital issues of insurance business like the investment of insurance funds and expenses of management, including commissions paid to agents, in addition to widening the authority of the Controller of Insurance. The salient features of the legislation in respect of the most important aspect for our purposes, namely, investment of funds, are described below.

The new investment policy of the LIC follows broadly Sections 27 and 27A of the Insurance Act, 1938, amended, however, in certain respects. According to Section 27, every life insurer was required to invest and at all times keep invested 25 per cent of its adjusted liabilities in Government securities and a further sum equal to not less than 25 per cent in Government securities or other approved securities (which are semi-Government securities, with Government guarantee for the repayment of principal and payment of interest); of the balance, not more than 15 per cent could be held in 'other' investments while the remaining (35%) had to be held in 'approved' investments as defined in Section 27A of the Insurance Act. Section 27A listed diifferent types of investments deemed to be approved investments under that Section. These included shares and debentures of joint stock companies, immovable property, first mortgages on immovable property, loans on life interests or on policies of life insurance, life interests, fixed deposits with scheduled banks or co-operative societies, debentures or shares of co-operative societies, etc., but in order to be deemed as 'approved' investments, most of these had to satisfy the requirements specified under this Section.

Besides qualifications in respect of securities in which the insurer could invest, limits were also enforced on the amount to be invested. Thus, Section 27A(3) laid down that an insurer could not invest in the shares of any one banking company or investment company more than (a) $2\frac{1}{4}$ per cent of its adjusted liabilities or (b) 2 per cent of the subscribed share capital and debentures of the banking company or investment company concerned, whichever was less.

In case of a company other than banking and investment, in terms of Section 27A(4), an insurer could not invest more than (a) 2¼ per cent of its adjusted liabilities or (b) 10 per cent of the subscribed share capital and debentures of the company, whichever was less.

A further important restriction was that under Section 27A(5), an insurer was forbidden from investing in shares or debentures of any private limited company.

These were some of the main provisions of Section 27A which governed the investment policy of private life insurers prior to nationalisation. A formal declaration of the investment policy of the Corporation may be said to have been made with the issuance of a notification on August 23, 1958, which made Section 27A of the Insurance Act, amended in certain respects, applicable to the LIC. Under the new investment policy, as it now emerges, the investments of the controlled funds of the Corporation will continue to be divided into three broad categories, namely, (i) Government and approved securities (*i.e.* mostly semi-Government securities), (ii) investments approved under Section 27A and (iii) 'other' investments. As before, 25 per cent of the controlled funds should be held in Government securities, a further sum equal to not less than 25 per cent in Government securities or other approved securities and not more than 15 per cent in 'other' investments. Thus, the balance of about 35 per cent is to be held in 'approved' investments as defined in Section 27A of the Insurance Act. Two modifications have been made in Section 27A as now being applied. First, in terms of Section 27A(3) and 27A(4) of the Insurance Act, a private insurer could not hold more than 2 per cent of the subscribed share capital and debentures of banking and investment company and 10 per cent of the subscribed share capital and debentures of any one company (other than a banking company or an investment company). This has been modified so as to allow the LIC to hold upto 30 per cent of the equity share capital of a company, with a further provision for exceeding this limit with the prior approval of the Central Government. Second; under the old Section 27A(5), the insurers were prohibited from investing in private limited companies. Under the amended Section 27A(7), the LIC is now permitted to invest

in private limited companies also with the prior approval of the Central Government. As regards 'other' investments in which the LIC can invest upto 15 per cent of its controlled funds, these are to be made on an unanimous recommendation of the Investment Committee failing which, on a resolution of the Corporation passed by a majority of at least three-fourths of the members present at the meeting. [The Committee was set up under Section 19(2) of the Life Insurance Corporation Act, 1956, to advise the Corporation on matters relating to investment. Apart from members of the Corporation, this Commitee is to consist of others who have special knowledge of the subject].

In view of the fact that the LIC is the largest single investor in the country, its investment policies and operations would have a considerable effect on stock markets; besides, its being a nationalised institution may mean the pursuit of policies that are not governed wholly by business considerations. These aspects of the LIC's working figured in public and parliamentary debates following certain irregularities in the purchase by the Corporation, in mid-1957, of some shares belonging to the 'Mundhra group'. Consequently, when the Finance Minister announced in Parliament the investment policy of the Corporation in August 1958, he referred to the above aspects of the matter. The Finance Minister made it clear that whereas the LIC will always keep in mind that its primary obligation is to its policyholders whose money it holds in trust, and will work as far as possible on business principles, it will never lose sight of the fact that as the largest single investor in India, it has to keep before it the interests of the community as a whole. As regards the LIC's investment operations *vis-a-vis* the stock markets, while emphasising that there is not the slightest intention that the LIC should indulge in speculation and thus take advantage of temporay fluctuations in market prices, as its investment must necessarily be on a long-term basis, the Finance Minister stated that, this should not preclude it from certain buying and selling when circumstances so warrant. If, for instance, the LIC were to sell during periods of boom and to buy during periods of depression, not only would the LIC stand to gain, but indirectly, the national interest would be served by evening out the fluctuations in the stock market.

(d) PROVIDENT FUNDS

Contribution to provident funds is yet another important source of saving in the community, and as in similar cases, it is necessary to ensure the safety of the funds. Till 1952 when the Employees' Provident Fund Act was passed, provident fund was not compulsory for industrial units. However, relatively large industrial establishments had provident funds, besides certain industries like coal mines. In the case of coal mines, there has been separate legislation since 1948. However, there has been control over the investment of provident funds, under the Income-tax Act, insofar as exemption is sought for from income-tax on contribution to provident funds. The funds which are given exemption are called Recognised Provident Funds in accordance with the provisions of Chapter IX A of the Indian Income-Tax (Provident Funds Relief) Act, of 1929. The conditions of recognition are sufficiently comprehensive and stringent to ensure proper working of all provident funds, intending to avail of exemption from income-tax. Among the conditions of recognition are that the accumulated balances should be wholly invested in securities specified in Section 20 (clauses (a) to (e)) of the Indian Trusts Act, 1882, which are re-payable both in respect of capital and of interest in India. In effect, this means investment in gilt-edged and semi-gilt-edged securities.

The Employees' Provident Funds Act of 1952 is being gradually extended to cover almost all industries. The act applies to such factories/establishments as employ 50 or more workers. The basic wage limit for eligibility to membership of the provident funds is now Rs. 500 per month (inclusive of dearness allowance and cash value of food concession) to which it was raised from Rs. 300 with effect from May 31, 1957. The rate of contribution by the employee is $6\frac{1}{4}$ per cent of the total basic wage, dearness allowance and cash value of food concession. An equal amount is paid by the employer. Recently, decision was taken to permit employees to raise their contribution to $8\frac{1}{3}$ per cent without any increase, for the time being, in the contribution of the employers.

Establishments which have more favourable schemes of provident funds are exempted from the purview of the Act. Extension of the Act to establishments employing even less than 50

persons is provided for by the Act. It was announced in December 1959, by the Union Labour Minister, that the Act was being extended to establishments employing 20 or more persons.

The investment of the provident fund contributions under the 1952 Act is done under the directions of the Government. They are being invested exclusively in Central Government securities. The present pattern of investment of funds in these securities is: (a) National Plan Savings Certificates—10 per cent, (b) Medium-dated securities—20 per cent (Treasury Savings Deposit Certificates—10 per cent and other medium-dated securities—10 per cent) and (c) long-dated securities—70 per cent. The preponderance of long-dated securities reflects probably that considerations of capital depreciation are less important in the investment of these funds since the securities can be held till maturity. The coal mines provident funds are also invested in National Plan Savings Certificates (10 per cent) and Government securities. Contribution to provident fund has been compulsory in the case of most State Government employees; in the case of Central Government employees, it was optional but in December 1959 Government took a decision to make it compulsory.

The provident fund contributions of Government employees are not invested separately. They are merged in the unfunded debt of Government.

There have been proposals for bringing all provident funds under the charge of a single organisation and for the setting up of a single agency which would assume administrative responsibility for the Provident Fund Acts as well as the Employees' State Insurance Act. Besides, the conversion of the provident fund schemes for workers into a pension-cum-gratuity has also been suggested.

(e) CAPITAL ISSUES CONTROL

We may now briefly discuss the history and features of Capital Issues Regulation. Basically, the object of capital issues regulation is different from that of Companies Act. The latter is concerned mainly with the disclosure of all information relating to the issue of capital by a company as also its day-to-day working. The object of capital issues control, on the other hand, is

to regulate the flow of investment in such a way that the limited capital resources are used for purposes which are in line with the Government's general economic policy. In a planned economy, so far as the allotment of resources is concerned, therefore, the capital issues control is a tool of considerable importance though, as mentioned earlier, such regulation existed in India even before the commencement of the Five-Year Plans.

Control over issue of capital was first imposed in May 1943, by the promulgation of the Capital Issues (Control) Order in terms of Rule 94A of the Defence of India Rules. The order was mainly instituted to prevent diversion of available investible funds for purposes which made little or no positive contribution to the prosecution of the war and to the early production of consumer goods or other purposes beneficial to the general public interest. Even after the end of the war, the continuance of control over issue of capital was felt necessary to counteract the inflationary pressures which had continued unabated. Further, its usefulness as a first step in the evolution of an investment policy to secure balanced investment of the country's resources came to be recognised. Thus, the control was continued first by the issue of an ordinance and thereafter by the Capital Issues (Continuance of Control) Act passed in April 1947, which provided for the continuance of the control for a further period of 3 years, *i.e.* upto March 1950. The control was again extended twice, first for a further period of two years, *i.e.* upto March 1952, and then for four years, *i.e.* upto March 1956. In February 1956, a bill to extend indefinitely the Capital Issues (Continuance of Control) Act, 1947, was enacted. This was because in the context of our Five-Year Plans the need for effective control of investment in the private sector had become all the more important. It is essential that the limited resources should be directed in the desired channels.

To turn to the main provisions of the Capital Issues (Control) Act. The Act extends to the whole of India except the State of Jammu and Kashmir and it applies to all persons in India and to citizens of India even if resident outside India. The term 'issue of capital' has been defined in the Act as issue of any securities whether for cash or otherwise, and also covers (by an amendment made in December 1957) capitalisation of profits or reserves

for the purpose of converting partly-paid shares into fully-paid shares or increasing the par value of shares already issued. The term 'securities' has been defined as (i) shares, stocks and bonds, (ii) debentures, (iii) mortgage deeds, instruments of pawn, pledge or hypothecation and any other instruments creating a charge or lien on the assets of the company and (iv) instruments acknowledging loan to or indebtedness of the company and guaranteed by a third party or entered into jointly with a third party. The Act provides that no company whether incorporated in or outside India shall, except with the consent of the Central Government, make an issue of capital *in India*, or make in India any public offer of securities for sale, or renew or postpone the date of maturity or repayment of any security maturing for payment in India. Companies incorporated in India are also prohibited from making an issue of capital *outside* India, without the consent of the Central Government. Government is empowered (i) to qualify any consent or recognition accorded by it with such conditions as it may think fit to impose and (ii) to revoke the consent or recognition accorded by it or vary all or any of the conditions qualifying the consent. The Act prohibits persons from circulating any offer for subscription or purchase of any securities unless consent has been accorded by the Central Government to the issue or creation of such securities. Similarly, no person shall without the consent of the Central Government circulate any offer, being a public offer, if the order according consent contained a condition that the security should be privately placed. The Act also prohibits persons from accepting or giving any consideration for any issue of capital made or proposed to be made in India unless the consent or recognition of the Central Government has been accorded to such issue. The Central Government is empowered under Section 6 of the Act to grant exemption from all or any of the provisions summarised above; Government has also the power of condonation. Under the Act, an officer authorised by the Central Government may require any company or any officer of any company to submit to him such accounts, books or other documents or to furnish to him such information as he may reasonably think necessary.

The Act provides for the setting up of an Advisory Committee consisting of not more than 5 members to which Government may refer from time to time such matters arising out of the administra-

tion of the Act, as the Central Government may think necessary. The Central Government is also empowered to make rules for carrying out the purposes of the Act. All such rules are required to be laid for not less than 30 days before each House of Parliament as soon as possible after they are made and shall be subject to such modifications as Parliament may make during the session in which they are so laid or the session immediately following.

In terms of powers derived under Section 6, the Central Government issued in January 1949, the Capital Issues (Exemption) Order, 1949, in supersession of the Exemption Orders issued earlier. The 1949 Order exempts the following securities from the provisions of Section 3, 4 and 5 of the Act, dealt with earlier.

(i) The issue of securities other than bonus shares, by any company, not being a banking or an insurance company, or a provident society, provided that the value of consideration involved in such issue together with that involved in any previous issue made by such a company within the 12 months preceding such issue does not exceed Rs. 5 lakhs. In August 1959, this limit was raised to Rs. 10 lakhs.

(ii) The issue by a banking company of any shares in consequence of alteration, reduction or reorganisation of the share capital in compliance with sub-section (2) of Section 277 I of the Indian Companies Act, where the total amount of the existing subscribed capital is not thereby increased,

(iii) Loans granted by the Industrial Finance Corporation of India under the I.F.C. Act and debentures taken up by the Corporation, and

(iv) Issue and acceptance of securities other than debentures made by a person in the ordinary course of his business and solely for the purpose of that business to another person carrying on the business of banking or to such other person's nominee in respect of advances or overdrafts from time to time granted or to be granted by such other person.

Control over capital issues is administered at present by the Department of Economic Affairs, Ministry of Finance, in the 'control of capital issues, stock exchanges and finance corporations' Division.

As referred to earlier, the Capital Issues (Control) Act provides for the constitution of an Advisory Committee consisting of not more than five persons to which the Central Government may refer for advice any matter arising out of the administration of the Act. This Advisory Committee consists of representatives of organised trade and industry and of the general public and is usually presided over by a person with wide knowledge and experience of company matters, management and company finance. The Advisory Committee does not deal with individual applications or specific cases which must necessarily be left to the decision of Government. But the Committee is consulted on major issues of policy relating to corporate investments on which Government may consider it necessary to have the views of the Committee. The Committee meets two to three times in a year.

Sanction for capital issue is decided by taking into consideration the following factors, financial as well as technical. (1) Whether all the capital asked for is likely to be required in the immediate future or, if there is any phased programme of expansion by the company applying for licence, (2) whether the company has already at its disposal adequate funds locked up in less desirable investment, (3) the terms of capital issue, whether at par or at a premium, (4) the amount of underwriting and brokerage charges, (5) whether the proposed issue is likely to cause an imbalance in the capital structure of the company as between equity and fixed interest-bearing capital, (6) whether the terms of the proposed issue are otherwise than in conformity with the provisions of the Companies Act and (7) whether the appointment or re-appointment of managing agents has been according to the provisions of the Companies Act. In disposing of the applications the concerned Ministry is also consulted, to ensure that the business objects of the company are in line with Government policies and that the sum asked for is reasonable.

Also, where a licence has been subject to the approval of the terms of collaboration of a foreigner, no consent can be issued until those terms have been finally aproved. Besides, there are a few technical requirements laid down by the Advisory Committee, for the grant of consents for capital issues. These relate to (i) maintenance of a particular ratio between equity (including free reserves) and fixed interest bearing capital and (ii) raising of a certain mini-

mum percentage of capital by private subscription before consent can be granted for a public issue, in the case of *new* issues. Applicants are divided into two classes: industrial concerns and non-industrial concerns. In regard to industrial concerns, the principle is to exclude those industries which do not fall roughly within the limits of the Five-Year Plans. In regard to non-industrial concerns like banking and insurance companies and airlines, permission is refused if it is felt that the field is too overcrowded. Now, of course, life insurance and airlines business are nationalised. Permission is also refused (i) to companies whose financial position is unsatisfactory, in order to safeguard the interest of the small investor, (ii) in case of speculative enterprises and (iii) when bonus shares are sought to be issued (a) either on the revaluation of assets or (b) by companies not having sufficient genuine reserves.

Bonus issue applications are refused where the company is not under-capitalised or where the issue is otherwise considered not in the public interest or where the residual free reserves do not bear a reasonable ratio (generally 20 per cent) of the increased paid-up capital.

Once issues of capital are sanctioned, companies are, as a rule, allowed a period of 24 months to raise the amount sanctioned and are required to submit a statement to the Controller of Capital Issues at the end of the first 6 months and thereafter at the end of every 3 months showing the amount actually raised by them. In practice, according to the statement made in Parliament by the Finance Minister in February 1956, very few companies regularly submit the returns due from them and one important administrative problem was to reorganise and strengthen the machinery for follow-up work. Suitable separate cells, he stated, were, therefore, created in almost all the important offices of Registrars of Joint Stock Companies and these, he hoped, would make it easier for Government to obtain data relating to actual raising of capital against consents granted.

It is rather difficult to pass a judgment on the extent to which the objectives of capital issues control have been fulfilled. It has been observed that in respect of the amount of capital the percentage of consents to applications is quite high, being of the

order of 80 to 90 per cent. Incidentally, it was so in the U.K. also. This high percentage could be due either to applications being generally of high standard or to the control being of a routine character. The control has, however, done much to ensure a healthy capital structure. It has also exercised a generally healthy influence in the matter of capitalisation of reserves; profits from revaluation of assets have not been permitted to be capitalised. Undoubtedly the control has been, by and large, negative in approach, but no control apparatus can have a positive approach, though indirectly the flow of investment into desired channels is likely to be achieved.

There have been suggestions from the business community that the control of capital issues should be scrapped, and that in any case relaxations should be effected, these demands being intensified after substantial relaxation of the corresponding regulations in the U.K. in July 1958. It would, however, be undesirable to abandon this instrument of regulation of investment in the economy. In a planned economy of the type we are building there is absolute need for a control apparatus like control of capital issues, notwithstanding the existence of other regulatory measures like the system of industrial licensing under the Industries (Development and Regulation) Act and the Companies Act. A somewhat stronger case has, however, been made for the raising of the exemption limit of Rs. 5 lakhs per year, on the ground, among other things, that there has been a substantial rise in the cost of setting up of industrial units. The Advisory Committee on Capital Issues recommended the raising of the limit to Rs. 15 lakhs. As mentioned earlier, Government decided, in August, 1959, to raise the exemption limit to Rs. 10 lakhs. While the private sector should legitimately press for relaxation of restrictions, so far as the requirements of a planned economy go, it is necessary to regulate the investment in the private sector. As a matter of fact, the control should be extended to the employment of company reserves, i.e. owned funds. This was in fact done in November 1956, when the then Finance Minister, Shri T. T. Krishnamachari, introduced the scheme of compulsory deposit of a part of current reserves of companies, though the contemplated (but happily not implemented) regulation of investment of past reserves was misconceived. However,

this was withdrawn in less than a year. It is true that there are difficulties in administering it but in an economy which has embarked on central planning, administrative considerations should not stand in the way of employing important regulatory measures. Of course, things should be disposed of without delay, and this is perhaps being done as the administrative machinery has by now acquired more experience.

Criticism has also been offered regarding insistence, by the Controller of Capital Issues, of some rigid ratios between equity and preference capital; recently some relaxation was effected. Strong objection has been taken, which appears to have considerable force, to the regulation, by the capital issues control administration, of the fixation of the price at which the new capital is to be issued. There has also been considerable criticism about the vagaries of Government policy with regard to the sanction of applications for issue of bonus shares. This is probably connected with Government's policy of taxing bonus issues; however, it is desirable to avoid too frequent changes in policy. Although this is not quite the place to discuss it, it would appear that the bonus tax itself is misconceived and runs counter to the policy of encouraging companies to retain in the business a relatively larger share of profits.

In regard to the administration of the various statutes concerning the corporate sector, one suggestion that may be made is the establishment of a single quasi-independent body, on the lines of the Securities and Exchange Commission of the United States. That body administers all the allied statutes, namely, the Securities Act (corresponding to our Companies Act), the Securities Exchange Act (corresponding to our Securities Contracts Regulation Act), the Investment Company Act and three or four other statutes. The Bhabha Committee on Company Law Reform also made a similar recommendation. The then Finance Minister did not rule out the establishment of such a body, but in the first instance he decided to set up a separate department of the Ministry, namely, the Department of Company Law Administration, which is now part of the Ministry of Commerce and Industry. At present, capital issues control comes within the jurisdiction of the Ministry of Finance, which is also in

charge of the regulation of trading in securities. For the latter purpose, a directorate is being set up, with headquarters at Bombay. The time seems to be ripe for the establishment of a commission, to which may be entrusted the administration of the Companies Act, the Capital Issues (Control) Act, the Securities Contracts (Regulation) Act and any other similar statute that may be enacted. This will ensure proper co-ordination of policies and generally contribute to efficient administration of the enactments.

(f) REGULATION OF BANKING

A brief reference may also be made to the regulation of commercial banks. In terms of the Reserve Bank of India Act, the Reserve Bank possesses the usual instruments of general credit control in regard to scheduled banks (i.e. member banks). The Reserve Bank also possesses wide powers of direct regulation, in respect of scheduled and all other commercial banks, in terms of the Banking Companies Act, 1949. This Act is a comprehensive measure covering the establishment, the working and liquidation of banks, all with a view to protecting the interests of depositors. Minimum requirements of capital, reserves and liquid assets are stipulated. The opening of branches and amalgamations are subject to the Reserve Bank's approval. The Reserve Bank has direct powers of regulating the manner in which banks employ their funds. Through a system of regular inspection of banks, the Reserve Bank has done much to raise standards of banking and to contribute to the growth of banking habit.

The role of the Reserve Bank and of Government in the field of banking has not been merely a negative one. Increasing attention is also being paid to the development of banking facilities, especially in areas where they are not available or are inadequate. India's biggest commercial bank, the State Bank of India, which is now predominantly State-owned, has launched a programme of vigorous expansion of branches. The Reserve Bank has also sought to promote banking development through progressive liberalisation of remittance facilities.

It is not enough to have comprehensive statutes; they must be enforced with vigour and at the same time with understanding. One gathers the impression that there is scope for considerable improvement in these directions. This requires an adequate number of personnel possessing both ability and integrity. In the post-independence period there has been a vast expansion in the administrative and economic functions of Government. Consequently, there has been an acute shortage of competent personnel, with the result that enforcement has not been wholly satisfactory. However, it would appear that the situation is being remedied.

Chapter 3

GROWTH OF CAPITAL MARKET — STATISTICAL ANALYSIS

We shall now make a statistical review of the growth of the Indian capital market. We shall analyse the data relating to the working of the corporate enterprise, new issues of capital, life insurance business and investments, provident fund collections, volume and composition of Government debt, the growth of post office savings bank business and other types of small savings and finally the growth of commercial bank deposits, especially of savings and time deposits.

(a) CORPORATE ENTERPRISE

A very important indicator of the growth of the capital market is the growth of corporate enterprise, i.e. joint stock companies. During the 11-year period 1948-59, the number of joint stock companies at work increased from 22,675 to 27,479 (Table 1). These figures include Government companies also, which are on the increase during the last few years, following the establishment of industries by Government under the Five-Year Plans. The growth has, however, been rather erratic. The bulk of the increase occurred during the years 1948-52 after which the rate of increase slowed down considerably and in the three years 1956-59 there was a *decrease* in the number of companies by about 2,400. This is largely explained by the coming into force of the Companies Act, 1956, as a result of which many companies probably found it difficult to comply with the provisions of the new legislation. It is officially reported that many of them were virtually defunct, so that the decrease in the number of companies at work should be regarded as strengthening of the corporate sector; it will be noticed that during these years the paid-up capital recorded a rise. The total paid-up capital of the joint stock companies at work more than doubled

TABLE 1
JOINT STOCK COMPANIES AT WORK

(Paid-up capital in crores of Rs.)

As at the end of the financial year	Public Limited Companies		Private Limited Companies		Total	
	Number	Paid-up capital	Number	Paid-up capital	Number	Paid-up capital
1947-48	N.A.	N.A.	N.A.	N.A.	22,675	570
1948-49	N.A.	N.A.	N.A.	N.A.	25,340	528
1949-50	N.A.	N.A.	N.A.	N.A.	27,558	724
1950-51	12,568	566	15,964	209	28,532	775
1951-52	12,413	607	16,810	249	29,223	856
1952-53	12,055	629	17,257	269	29,312	898
1953-54	10,237	625	19,255	316	29,492	941
1954-55	10,056	661	19,569	308	29,625	970
1955-56	9,575	690	20,299	334	29,874	1024
1956-57	8,810	715	20,547	363	29,357	1078
1957-58*	8,266	754	20,017	505‡	28,283	1259‡
	(40)	(18)	(51)	(186)‡	(91)	(204)‡
1958-59*	7,760	784	19,719	732§§	27,479	1517§§
	(37)	(19)	(66)	(405)§§	(103)	(424)§§

Note:- Figures in brackets relate to Government companies.

N.A. = Not Available.

* Provisional figures.

‡ Includes Rs. 156 crores paid-up capital of the Hindustan Steel

§§ Includes Rs. 300 crores paid-up capital of the Hindustan Steel.

Sources: Monthly *Blue Books* on Joint Stock Companies in India and *Annual Reports on the Working and Administration of the Companies Act*, 1956.

during the decade, from Rs. 570 crores to Rs. 1,217 crores, excluding Rs. 300 crores of the Government-owned Hindustan Steel Limited. A part of the rise in capital is due to the capitalisation of reserves. At the end of 1958-59, there were 37 public and 66 private limited Government companies, with paid-up capital of Rs. 19 crores and Rs. 405 crores, respectively, of which Hindustan Steel Limited accounted for Rs. 300 crores.

An interesting feature of the growth of joint stock enterprise is the steady decline in the number of *public* limited companies and a rise in *private* limited companies. It would appear that this trend is due to the comparative advantage possessed by the private companies in the matter of disclosure of information and other statutory requirements. Public companies also found it convenient to convert themselves into private ones. During the period 1951-59, for which separate data are available, the number of public limited companies declined from 12,568 to 7,760; on the other hand, the number of private limited companies rose from 15,964 to 19,719. The number of private companies rose continuously upto 1956-57, the peak of the annual rise being in 1953-54, with an increase of about 2,000 companies which corresponded to an equally sharp decline of about 1,800 companies in the case of public limited companies. However, in the years 1957-59, private limited companies also recorded a substantial decline of over 800 which, as already mentioned, would appear to be due to the coming into force of the new Companies Act. Notwithstanding the decline in the number of public limited companies, there was an increase in the paid-up capital which during the 8-year period for which data are available rose from Rs. 566 crores to Rs. 784 crores. In the case of the private limited companies, of course, the rise in capital was proportionately much larger, from Rs. 209 crores to Rs. 432 crores, excluding the Rs. 300 crores of Hindustan Steel Limited.

(b) CAPITAL ISSUES CONTROL STATISTICS

It may also be useful to analyse statistics relating to capital issues control. Although what matters is the actual issue of capital by companies, statistics relating to applications to issue capital and the grant of consents by Government throw some light on company formation potential. Recently, data have become

available about capital raised by companies which have been granted consents by the Controller of Capital Issues. These data reveal an encouraging picture of the Indian capital market. A good portion of consents has been utilised to raise capital. The total capital for which consent was given to non-Government companies (and excluding bonus issues but including miscellaneous issues *e.g.* Loans) showed a decline between 1950 and 1952 from Rs. 67 crores to Rs. 25 crores, but from 1953 onwards there was a continuous rise, the peak being reached in 1956 with an amount of Rs. 162 crores; in the next two years the amount declined sharply to Rs. 122 crores and Rs. 83 crores, respectively (Table 2). Applications for issue of capital for industrial purposes have been predominant, in keeping with the pattern of economic development in the country. Thus, consents for industrial issues have accounted for 75 to 85 per cent of total consents. Likewise, generally speaking, initial issues (i.e. issues by new companies) have been more important than further issues by existing companies.

TABLE 2

CAPITAL ISSUES CONTROL — TOTAL CONSENTS

(Rs. Crores)

Year	Private Sector		Government Companies	Total Consents	
	Including Bonus Issues	Excluding Bonus Issues		Including Bonus Issues	Excluding Bonus Issues
1950	75.4	66.8	2.5	77.9	69.3
1951	56.5	45.7	3.1	59.6	48.8
1952	33.2	25.4	6.6	39.8	32.0
1953	71.9	57.2	9.5	81.4	66.7
1954	101.3	91.4	9.3	110.6	100.7
1955	118.8	112.3	6.6	125.4	118.9
1956	170.8	162.3	59.4	230.2	221.7
1957	137.8	122.3	18.0	155.8	140.3
1958	93.9	83.2	333.5	427.4	416.7

Source:- Quarterly Statistics on the Working of Capital Issues Control.

It was mentioned earlier that the actual sums of capital raised by companies in possession of consents have been quite substantial. These data in respect of non-Government companies for which information is available are presented in Table 3.

TABLE 3

CAPITAL ISSUES CONTROL — UTILISATION OF CONSENTS: 1950-57

(Rs. crores)

Year	Type of Issue	Total amount sanctioned	Amount subscribed	Amount paid-up
1	2	3	4	5
1950	(i) Share capital for cash	48.39	27.19	23.85
	(ii) ,, ,, ,, ,, (Govt. Companies)	2.45	2.40	2.40
	(iii) Bonus Issues	8.59	8.25	8.25
	(iv) Debentures	18.01	14.56	14.56
1951	(i) Share capital for cash	41.21	18.49	17.15
	(ii) ,, ,, ,, ,, (Govt. Companies)	2.85	2.50	2.31
	(iii) Bonus Issues	10.40	9.71	9.71
	(iv) ,, ,, (Govt. Companies)	0.28	0.28	0.28
	(v) Debentures	4.12	3.17	3.17
1952	(i) Share capital for cash	21.36	12.03	11.63
	(ii) ,, ,, ,, ,, (Govt. Companies)	6.55	6.22	6.22
	(iii) Bonus Issues	7.77	7.19	7.19
	(iv) Debentures	2.99	2.30	2.30
1953	(i) Share capital for cash	41.57	30.90	30.74
	(ii) ,, ,, ,, ,, (Govt. Companies)	8.50	6.75	6.75
	(iii) ,, ,, ,, ,, (Statutory Corpn.)	1.00	1.00	1.00
	(iv) Bonus Issues	14.72	14.21	14.21
	(v) Debentures	11.72	9.56	9.56
1954	(i) Share capital for cash	66.18	45.43	35.95
	(ii) ,, ,, ,, ,, (Govt. Companies)	8.25	7.60	6.91
	(iii) Bonus Issues	9.50	9.12	9.12
	(iv) ,, ,, (Govt. Companies)	0.38	0.20	0.20
	(v) Debentures	20.29	17.23	17.23

1955	(i) Share capital for cash		69.84	31.03	29.22
	(ii) " " " "	(Govt. Companies)	4.04	3.35	3.35
	(iii) " " " "	(Statutory Corpn.)	0.50	0.50	0.50
	(iv) Bonus Issues		6.47	5.41	5.41
	(v) Debentures		17.38	7.66	7.66
	(vi) "	(Govt. Companies)	0.05	0.03	0.03
1956	(i) Share capital for cash		98.62	59.11	53.49
	(ii) " " " "	(Govt. Companies)	58.25	39.47	32.84
	(iii) Bonus Issues		8.50	7.50	7.50
	(iv) Debentures		10.35	4.20	4.20
	(v) "	(Govt. Companies)	1.15	0.51	0.51
1957	(i) Share capital for cash		70.07	37.48	24.54
	(ii) " " " "	(Govt. Companies)	13.35	11.36	9.36
	(iii) Bonus Issues		15.52	9.46	9.46
	(iv) Debentures		9.68	6.93	6.92
Total: 1950-57					
	(i) Share Capital for cash		457.24	261.66	226.57
	(ii) " " " "	(Govt. Companies)	104.24	79.65	70.15
	(iii) " " " "	(Statutory Corpn.)	1.50	1.50	1.50
	(iv) Bonus Issues		81.47	70.85	70.85
	(v) " "	(Govt. Companies)	0.67	0.48	0.48
	(vi) Debentures		94.53	65.61	65.60
	(vii) "	(Govt. Companies)	1.20	0.54	0.54

Note: Figures of amounts subscribed and paid-up are shown against the year in which consents in respect of those issues were given and not against the year in which the amounts were actually raised. Thus Rs. 29.22 crores shown against 1955 under share capital were raised not in 1955 but by companies which were given consents in 1955 for issue of capital.

Source:— Quarterly Statistics on the Working of Capital Issues Control.

During the 8-year period 1950-57, out of a total consent for Rs. 552 crores (excluding bonus shares), the amount subscribed was Rs. 327 crores and the amount paid up Rs. 292 crores, comprising Rs. 226 crores of share capital and Rs. 66 crores of debentures. Since for not all companies is information available, the actual amount raised by the private sector is larger than indicated by the above figures. It should be emphasised that the figures given against each year relate to the year in which consents in respect of those issues were given and not to the year in which the amounts were actually raised. For the years 1957 and 1958, however, comprehensive data are available in respect of capital raised in each of the years (Table 4). It will be seen that in 1957 the total amount raised by non-Government companies amounted to Rs. 55 crores. The 1958 data are partial and indicate a decline in the capital raised to Rs. 38 crores.* These figures relate to capital raised against consents only and do not take into account figures of capital raised under exemption order; the amount thus raised was Rs. 9.51 crores in 1957 and Rs. 8.32 crores in 1958.

(c) WORKING OF CORPORATE ENTERPRISE

It would also be useful to review briefly the working of the corporate sector in India in recent years. During the last 5 years, the Department of Research and Statistics of the Reserve Bank of India has been publishing comprehensive annual surveys of the financial results of public limited joint stock companies. At first a sample of 750 public limited companies, accounting for about two-thirds of the paid-up capital of the sectors covered (finance companies and Government companies being the main groups excluded from the coverage) was taken; this sample has since been raised to 1001 companies, accounting for about three-fourths of the paid-up capital of the sectors covered. Very recently, the Reserve Bank also carried out a study of the finances of 333 private limited companies. These statistics give a fairly encouraging picture of the working of the joint stock enterprises

* Available data indicate that in 1959 the amount raised was significantly larger than in 1958.

TABLE 4

CAPITAL RAISED IN 1957 AND 1958 BY NON-GOVERNMENT COMPANIES*

(Rs. crores)

Type of Issue	1957			1958		
	Public	Private	Total	Public	Private	Total
Initial (a) Ordinary	6.96	2.72	9.68	4.92	5.13	10.05
Preference	0.87	0.28	1.15	0.68	0.05	0.73
Further (b) Ordinary	27.72	2.63	30.35	12.02	2.81	14.83
Preference	3.81	0.21	4.02	2.33	0.46	2.79
Debentures	9.26	0.53	9.79	9.01	0.11	9.12
	48.63	6.38	55.01	28.95	8.56	37.51
Bonus	5.55	0.72	6.27	10.71	0.28	10.99
Miscellaneous (e.g. loans)	37.86	1.64	39.50	18.45	0.11	18.56
Total	92.03	8.74	100.77	58.11	8.95	67.06

Note:— Figures relate to capital raised in 1957 and 1958 against consents granted during the respective year as well as earlier years. The data are consolidated by the Controller of Capital Issues based on reports received from the companies/registrars of companies upto April 15, 1959. These do not take into account capital raised by companies about which no reports were received.

(a) Issues of new companies. (b) Issues of existing companies.

* Figures of capital raised under exemption order are not included in the table; they amounted to about Rs. 9 crores and Rs. 8 crores in 1957 and 1958, respectively.

Source: Reserve Bank of India, *Report on Currency and Finance*, 1958-59.

in India. The rate of growth of investment has been quite phenomenal in recent years in keeping with the accelerated tempo of development of the Indian economy under the impetus of the First and Second Five Year Plans. From 1953 onwards there has been a steady growth in investment; profits also rose continuously till 1956; in 1957, however, there was a set-back. The performance of individual industries obviously shows divergence, reflecting special problems affecting them, but, on the whole, the growth of the corporate sector should be regarded as satisfactory. International comparisons are extremely difficult to make because of non-availability of data on a uniform basis, though in this respect it may be a pleasant surprise to note that Indian statistics are far more comprehensive than the data available for many other developed countries. However, some rough studies in respect of three countries, namely, U.S.A., U.K. and Japan, indicate that the rate of profits in India, by and large, compares not unfavourably with that in other countries.

In Table 5 are given the details of income and expenditure of 750 companies for the years 1950 through 1955 and of 1001 companies from 1955 to 1957. It will be noticed that dividend distribution has tended to be somewhat steady, with the result that the impact of variations in profits has largely been on retained profits. Between 1952 and 1955, a progressively larger share of profits was utilised for reinvestment, the ratio rising from 21 per cent of profits after tax to 46 per cent; but in 1956 and 1957 there was a decline to 40 and 21 per cent, respectively. The average for the First Plan period was 39 per cent. Table 6 gives certain percentages of profitability for all the companies considered together. The various ratios of profitability showed a continuous rise from 1953 to 1955. In 1956, however, there was a small decline, which became very pronounced in 1957. Three ratios, namely, (i) profits after tax as percentage of net worth, which is probably the most satisfactory indicator of profitability, (ii) dividend as percentage of paid-up capital (which is rather a crude way of measuring either profitability or distribution to shareholders) and (iii) dividend as percentage of net worth (a satisfactory guide to rate of distribution to shareholders) are given

in Table 7 for important groups of industries for each of the years 1955 to 1957. It will be seen that for all the companies together, the ratio of profits after tax to net worth as well as of dividends to paid-up capital are about the same, being generally around 8-9 per cent; the ratio of dividends to net worth is much smaller, around 5 per cent. Also, the first two ratios show wide divergence among the various groups, whereas the third (ratio of dividend to net worth) shows much smaller variations.

In Table 8 are given the various profits ratios for India and three foreign countries, namely, U.S.A., U.K., and Japan. There are, as already mentioned, many limitations in comparing the data; even so, they are useful. As regards the two most important ratios, namely, profits after tax as a percentage of net worth and dividends as percentage of paid-up capital, the Indian figures compare not unfavourably with those of the other countries; in this connection it should be noted that the U.S. ratios will be actually lower if account is taken of the fact that shareholders have to pay tax on dividend income, a system that has now been introduced in India.

An analysis of sources and uses of funds reveals the rapid growth of the corporate sector. In respect of the 750 companies, the total of the sources/uses of funds, after declining sharply from Rs. 124 crores in 1951 to Rs. 32 crores in 1952, rose continuously to Rs. 136 crores in 1955 (Table 9). In respect of the 1001 companies, the total of the sources/uses of the funds in 1956 was Rs. 256 crores and for 1957, a little lower at Rs. 235 crores. Among the *uses* of funds, the rapid growth in fixed assets formation has been particularly significant. During the five-year period 1951-55, which roughly corresponds to the First Five Year Plan period, gross fixed assets formation at Rs. 271 crores constituted a little over 60 per cent of total assets formation; the annual figure rose from Rs. 33 crores in 1951 to Rs. 81 crores in 1955. As regards the 1001 companies, gross fixed assets formation was as much as Rs. 134 crores during 1956 and it was even larger at Rs. 174 crores in 1957. More than these absolute figures, the *rates* of capital formation will be found interesting. These figures are given in Table 10. The rate of growth recorded a marked rise from 1955 onwards, it being impressive in respect of fixed assets; this explains both the large deficit in balance of

TABLE 5

COMBINED INCOME, EXPENDITURE AND APPROPRIATION ACCOUNTS OF JOINT-STOCK COMPANIES

(Rs. crores)

	750 Companies						1001 Companies		
	1950	1951	1952	1953	1954	1955	1955	1956	1957
INCOME									
1. Main Income ...	831	1087	1044	964	1031	1144	1393	1558	1695
2. Other Income ...	18	22	21	19	19	22	15	17	20
3. Closing stock of finished goods and work-in-progress ...	125	156	157	151	161	166	201	252	279
4. Total ...	**973**	**1264**	**1223**	**1134**	**1211**	**1332**	**1609**	**1828**	**1994**
EXPENDITURE AND APPROPRIATIONS									
5. Opening stock of finished goods and work-in-progress ...	108	124	155	156	151	161	190	204	254
6. Manufacturing Expenses* ...	537	746	692	586	634	687	828	952	1027
7. Salaries and Wages	159	183	189	197	203	215	232	257	276
7a. Employees' Welfare Expenses							18	22	25
8. Interest ...	6	7	9	8	9	10	13	16	23
9. Managing Agency Remuneration ...	10	13	11	10	11	14	15	12	8
10. Bad Debts ...	—	—	—	—	—	1	1	1	—
11. Other Expenses† ...	66	79	84	82	94	111	103	129	139
11a. Excise Duty							50	59	84
12. Depreciation provision ...	24	28	27	29	30	35	43	47	53
13. Total (5 to 12) ...	**909**	**1179**	**1167**	**1068**	**1132**	**1234**	**1492**	**1699**	**1889**

TABLE 5 (Contd.)

	750 Companies						1001 Companies		
	1950	1951	1952	1953	1954	1955	1955	1956	1957
14. Profits before Tax ...	64	85	56	66	78	97	118	129	104
15. Tax Provision ...	25	34	25	27	33	38	51	59	51
16. Profits after Tax ...	39	52	31	39	46	60	67	70	53
17. Dividends ...	24	27	24	26	29	32	39	42	42
18. Retained profits ...	15	25	7	13	17	27	28	28	11
19. Total ...	**973**	**1264**	**1223**	**1134**	**1211**	**1332**	**1609**	**1828**	**1994**
15 as percentage of 14 ...	40	40	44	41	42	39	43	46	49
17 as percentage of 14 ...	37	32	44	40	37	33	33	33	40
18 as percentage of 14 ...	23	29	12	19	21	28	24	21	11
17 as percentage of 16 ...	62	52	79	68	64	54	58	60	79
18 as percentage of 16 ..	38	48	21	32	36	46	42	40	21

* Include cultivation expenses of plantation companies, operating expenses of shipping companies, purchases of trading companies, mining expenses, etc.

† Include figures in respect of excise duty for 1950-55.

Source: Reserve Bank of India Bulletins.

TABLE 6

SOME IMPORTANT RATIOS OF CORPORATE PROFITS AND DIVIDENDS

	750 Companies						1001 Companies		
	1951	1952	1953	1954	1955	1951-55	1955	1956	1957
A) Gross Profits* as percentage of Gross Sales	9.7	7.2	8.8	9.6	10.6	9.2	10.4	10.0	8.0
B) Gross Profits as percentage of total Capital Employed**	10.7	7.6	8.4	9.1	10.2	9.2	10.2	9.5	7.4
C) Profits after tax as percentage of Net Worth†	9.6	5.7	6.8	7.8	9.4	7.9	9.0	8.7	6.2
D) Dividends as percentage of paid-up Capital (Ordinary shares)	8.5	7.5	7.8	8.3	8.8	8.2	9.1	9.5	8.7
E) Dividends as percentage of Net Worth	5.0	4.5	4.6	5.0	5.1	4.8	5.2	5.2	4.9
F) Profits after tax as percentage of Total Capital Employed	5.2	3.2	3.8	4.2	5.0	4.3	4.7	4.3	3.0

* Including managing agents' remuneration, interest charges and provision for tax but excluding depreciation.

** Total net assets comprising net fixed assets and circulating capital.

† Paid-up capital plus all reserves (other than taxation and depreciation reserves) and balance of profit.

Source: Reserve Bank of India Bulletins.

TABLE 7

RATIO OF PROFITS AND DIVIDENDS TO NET WORTH AND PAID-UP CAPITAL IN 1955, 1956 AND 1957

Industry	No. of companies	1955 A.	1955 B.	1955 C.	1956 A.	1956 B.	1956 C.	1957 A.	1957 B.	1957 C.
1. Cotton Textiles	204	9.2	10.9	5.1	7.8	10.7	4.8	—	7.9	3.9
2. Jute Textiles	44	0.6	6.6	3.4	—	4.2	2.6	3.2	6.2	3.8
3. Other Textiles	11	9.3	3.9	2.9	9.6	4.7	3.0	7.5	4.7	3.2
4. Iron and Steel	2	21.9	12.6	5.0	14.6	9.3	4.0	11.2	9.2	4.0
5. Engineering	79	10.5	6.3	5.2	9.7	7.9	5.3	8.3	7.8	5.1
6. Cement	11	11.8	9.7	6.9	10.8	8.7	5.9	7.7	9.9	6.9
7. Sugar	72	7.9	11.8	5.8	9.0	12.1	6.2	9.4	11.8	6.1
8. Paper	13	10.2	10.9	5.5	6.1	11.0	5.4	7.2	11.2	5.3
9. Vegetable Oil	15	9.1	3.2	3.8	3.7	3.3	3.8	—	3.4	3.6
10. Chemicals	43	6.1	5.5	4.1	6.2	6.1	4.2	5.5	5.6	4.1
11. Matches	4	9.1	10.9	8.3	8.0	10.9	7.5	3.5	10.9	7.5
12. Coal	47	6.6	8.1	4.7	3.0	7.9	4.4	5.6	8.6	4.7
13. Electricity Generation & Supply	21	7.3	6.4	5.2	6.7	6.4	5.0	7.9	7.4	5.7
14. Shipping	10	2.5	6.3	3.6	10.9	8.1	4.2	11.6	8.2	4.4
15. Tea Plantations	167	5.5	16.1	7.3	11.4	16.1	7.8	3.9	10.0	5.0
16. Other Plantations	43	12.8	17.7	9.7	13.8	20.2	10.8	9.1	15.3	8.5
17. Trading	41	5.9	6.5	4.5	6.7	6.7	4.4	4.5	6.3	4.1
18. Total (including others)	1001	9.0	9.1	5.2	8.7	9.5	5.2	6.2	8.7	4.9

A. — Profits after tax as percentage of Net Worth *i.e.* paid-up capital plus all reserves (other than taxation and depreciation reserves) and balance of profit.

B — Dividends as percentage of paid-up capital (ordinary shares only)

C — Dividends as percentage of Net Worth.

Source: Reserve Bank of India Bulletin, August 1959.

TABLE 8

TRENDS IN COMPANY PROFITS IN SELECTED COUNTRIES, 1951-57

	1951	1952	1953	1954	1955	1955	1956	1957
I. Gross profits as percentage of total capital employed								
U.S.A.	13.6	11.5	12.1	10.7	12.9			
U.K.	12.0	11.0	11.2	11.6	11.9	11.9	12.0	11.2
Japan	15.8	12.3	12.1	11.3	10.4			
India	10.7	7.6	8.4	9.1	10.2	10.2	9.5	7.4
II. Tax provision as percentage of profits before tax								
U.S.A.	53.0	49.3	49.0	41.6	43.1	47.2	45.8	45.0
U.K.	62.2	61.6	58.4	56.3	52.6	52.6	53.7	53.1
Japan	34.0	43.2	46.1	50.1	55.8			
India	39.5	44.3	41.2	41.6	38.8	43.0	45.7	49.1
III. Profits after tax as percentage of profits before tax								
U.S.A.	47.0	50.7	51.0	58.4	57.2	52.8	54.5	54.6
U.K.	37.8	38.4	41.6	43.8	47.4	47.4	46.3	46.9
Japan	66.0	56.8	53.8	49.9	44.2			
India	60.5	55.7	58.8	58.4	61.2	57.0	54.3	50.9
IV. Distributed profits as percentage of profits before tax								
U.S.A.	26.8	30.9	29.1	34.3	30.4	23.8	24.9	27.0
U.K.	16.5	18.5	19.8	20.1	20.7	20.7	17.5	18.7
Japan	7.6	12.1	12.5	12.7	14.2			
India	32.0	44.0	40.0	37.0	33.0	33.0	33.0	40.0
V. Retained profits as percentage of profits before tax								
U.S.A.	20.1	20.0	21.9	24.1	26.7	29.0	29.6	28.0
U.K.	21.3	19.9	21.7	23.6	26.8	26.8	28.7	28.2
Japan	58.4	44.7	41.4	37.3	30.0			
India	29.0	12.0	19.0	21.0	28.0	24.0	21.0	11.0

TABLE 8 (Contd.)

	1951	1952	1953	1954	1955	1955	1956	1957
VI. Profits after tax as percentage of net worth								
U.S.A.	10.8	9.9	10.4	10.1	12.0			
U.K.	7.9	7.2	7.8	8.4	9.2	9.2	9.4	8.8
Japan	27.6	17.5	16.4	13.1	10.4			
India	9.6	5.7	6.8	7.8	9.4	9.0	8.7	6.2
VII. Dividend as percentage of paid-up capital								
U.S.A.	13.4	13.4	13.6	13.7	15.4			
U.K.	7.6	7.6	8.1	8.2	8.5	8.5	7.8	7.8
Japan	11.4	8.7	7.5					
India	8.5	7.5	7.8	8.3	8.8	9.1	9.5	8.7

U.S.A. : *Sources* — Federal Reserve Bank Bulletins and Security and Exchange Commission press releases. Data for 1951-55 relate to about 300 large corporations and for 1955-58 to all manufacturing corporations reporting to the Securities and Exchange Commision. Profits before tax are taken as gross profits.

U.K. : *Source* — London Economist. Data for 1951-55 relate to over 2,500 companies and for 1956 and 1957 to 2,300 companies.

Japan : *Sources* — Economic Statistics of Japan (Bank of Japan); Survey of Economic Conditions in Japan published by Mitsubishi Economic Research Institute, Tokyo. The number of companies covered vary from 3,500 to 5,000, except in case of the last ratio viz. dividend as percentage of paid-up capital which relate to about 1,000 companies for 1951 and 1952 and 600 companies for 1953.

India : *Source* — Reserve Bank of India Bulletins. The data for 1951-55 relate to 750 companies and those for 1955-57 to 1,001 companies.

TABLE 9

SOURCES AND USES OF FUNDS OF PUBLIC LIMITED COMPANIES

A. Sources of Funds

(Rs. Crores)

	750 Companies				1001 Companies	
	1951-55	1953	1954	1955	1956	1957
I. PAID-UP CAPITAL (excluding capitalised reserves)	31.08	5.76	3.62	11.35	21.87	27.49
II. BORROWINGS						
(a) From banks	26.46	— 6.37	14.17	7.71	64.75	48.22
(b) Mortgages	24.58	7.40	6.21	7.04	25.56	48.64
(c) Debentures	6.73	0.34	2.15	4.00	— 1.24	— 0.87
(d) Due to trade	16.20	— 1.46	3.74	7.55	43.15	39.83
(e) Others	16.28	0.61	4.33	6.18	5.63	6.33
Total	90.25	0.52	30.60	32.48	137.85	142.15
III. DEPRECIATION RESERVE	128.53	24.46	28.35	26.56	38.35	46.19
IV. TAXATION RESERVE	34.40	2.90	8.27	14.84	11.64	— 1.20
V. SAVINGS						
(a) Capitalised reserves	28.26	14.27	5.44	2.43	44.80	19.95
(b) General reserves	21.14	— 3.90	4.08	7.29		
(c) Development reserves	30.14	5.07	5.20	8.68		
(d) Other reserves	26.91	0.93	1.20	13.43		
(e) Balance of Profit	— 4.11	— 2.07	— 0.76	3.01		
Total	102.34	14.30	15.16	34.84	44.80	19.95
VI. MISCELLANEOUS AND E.P.T. REFUNDS	56.20	1.39	15.03	16.02	1.96	0.58
GRAND TOTAL	442.80	49.33	101.03	136.09	256.47	235.16

TABLE 9 (Contd.)

B. Uses of Funds (Rs. Crores)

	750 Companies				1001 Companies	
	1951-55	1953	1954	1955	1956	1957
I. GROSS FIXED ASSETS FORMATION						
(a) Land	9.93	1.91	2.05	3.03	0.96	1.70
(b) Buildings	44.03	8.27	10.61	10.44	21.61	18.23
(c) Plant and Machinery	190.58	33.80	46.29	60.24	100.32	146.02
(d) Others	26.36	4.47	4.51	6.90	10.96	7.66
Total	270.90	48.45	63.46	80.61	133.85	173.61
II. INVENTORY						
(a) Raw Materials	8.48	— 7.45	0.46	12.34	16.76	2.94
(b) Finished goods and Work-in-progres	41.10	— 5.31	10.04	4.83	50.88	26.40
(c) Stores	10.61	— 1.17	— 0.68	5.03	22.04	21.68
(d) Others	1.73	— 0.07	0.42	1.13		
Total	61.92	—14.00	10.24	23.33	89.68	51.02
III. LENDINGS						
(a) Tax advances	20.11	2.75	0.45	7.88	— 1.06	1.13
(b) Book debts	33.11	4.09	9.96	8.06	41.65	19.67
(c) Advance against goods	1.75	— 0.54	1.11	1.50		
(d) Others	14.64	0.74	6.07	1.41		
Total	69.61	7.04	17.59	18.85	40.59	20.80

TABLE 9 (Contd.)

B. Uses of Funds (Rs. Crores)

	750 Companies				1001 Companies	
	1951-55	1953	1954	1955	1956	1957
IV. INVESTMENTS						
(a) Government securities	3.52	1.26	2.49	0.53	— 1.55	— 3.90
(b) Semi-Government securities	— 0.10	— 0.10	— 0.01	0.01	0.08	— 0.11
(c) Industrial securities	14.62	2.97	3.42	3.91	— 0.01	4.88
(d) Miscellaneous non-current Assets**	4.48	— 1.45	— 1.10	2.41	3.27†	— 2.53†
Total	22.52	2.68	4.80	6.86	1.79	— 1.66
V. INCREASE IN MONETARY RESOURCES	17.85	5.16	4.94	6.44	— 9.44	— 8.61
GRAND TOTAL	442.80	49.33	101.03	136.09	256.47	235.16

** Mainly investments in subsidiary companies.

† Includes a small amount of miscellaneous current assets and miscellaneous intangible assets.

Source: Reserve Bank of India Bulletins.

TABLE 10

RATE OF CAPITAL FORMATION

(Financial and Government Companies excluded)

(Per cent per annum)

	750 Companies						1001 Cos.	
	1951-55 (average)	1951	1952	1953	1954	1955	1956	1957
Fixed Assets Formation (Gross)	8.3	5.9	7.8	7.6	9.3	10.8	14.3	16.3
Fixed Assets Formation (Net)	8.0	2.5	7.0	7.3	9.9	13.9	18.1	20.5
Inventory Accumulation	4.1	21.5	—5.3	—4.3	3.3	7.3	21.4	10.0
Total Capital Formation (Gross)	6.9	11.1	3.0	3.6	7.4	9.7	16.5	14.3
Total Capital Formation (Net)	6.2	11.7	0.5	1.5	6.8	10.9	19.6	15.8

Source: Reserve Bank of India Bulletins.

payments and the acute monetary stringency during the period. Inventory accumulation, as in most countries, has shown wide fluctuations. In Table 11 are given the pattern of sources and uses of funds for U.S.A., U.K. and Japan.

As regards *sources* of funds, internal sources (depreciation, taxation and other reserves grouped under savings) constituted the major source, accounting for about 60 per cent of the total sources of funds in the First Five Year Plan. The increase in paid-up capital was rather small. In 1956, there was a marked shift on account of the sharp rise in investment; in respect of the 1001 companies, external sources of finance (i.e. new share issues and borrowings) became much more important, accounting for 63 per cent of the total of the sources of funds as compared to only 44 per cent in 1955 in respect of the 750 companies. Of the external sources, bank credit was most important, constituting 25 per cent of the total source of funds, as compared to only 6 per cent in 1955. In 1957, external funds were even more important, constituting 72 per cent, though bank credit was much less important than in 1956. In the last 2 - 3 years borrowing from the World Bank has been an important source of finance, which is reflected in the sharp rise of the item 'other mortgages', the beneficiaries being the steel companies.

The pattern of assets and liabilities of the 1001 companies as at the end of 1957 is given in Table 12. Of the total net assets of Rs. 1831 crores at the end of 1957, net fixed assets constituted 41 per cent and inventories 31 per cent, as compared to 37 per cent and 29 per cent, respectively, at the end of 1955. Investments and cash together constituted 14 and 10 per cent, respectively, in 1955 and 1957. Net worth, i.e. paid-up *capital* plus free reserves, constituted 47 per cent of the total net assets, as compared to 53 per cent in 1955, the decline reflecting the growing dependence on outside finance. Likewise, there was a continuous decline in the ratio of current assets to current liabilities, from 1.49 in 1955 to 1.31 in 1957. It was as high as 1.65 in 1950 in respect of the 750 companies. Total borrowings amounted to Rs. 510 crores or 28 per cent, of which the largest item represented borrowings from banks, for Rs. 252 crores, followed by other mortgages for Rs. 103 crores.

TABLE 11

SOURCES AND USES OF FUNDS OF CORPORATIONS — INDIA AND SELECTED FOREIGN COUNTRIES

(Percentages)

	India			U.K.			U.S.A.			Japan
	1951-55	1956	1957	1951-55	1956	1957	1951-55	1956	1957	1951-55
SOURCES OF FUNDS										
(a) Internal sources (retained profits and depreciation) ...	59.9	37.0	27.6	49.5§	51.8§	52.0§	59.8	54.5	65.3	33.1
(b) External Sources: ...	40.1	63.0	72.4	50.5	48.2	48.0	40.2	45.5	34.7	66.9
Of which —										
(i) Capital raised from market including debentures* ...	21.2	12.7	15.6	62.0†	45.2†	66.0†	52.0	36.3	76.7	24.7
(ii) Bank borrowings* ...	15.0	40.0	28.3	5.5	12.9	2.3	11.2	10.1	2.3	49.6
(iii) Other sources+ * ...	63.8	47.3	56.1	32.5	41.9	31.7	36.8	53.6	21.0	25.7
USES OF FUNDS										
A. Fixed Assets ...	61.3	52.2	73.8	48.3	59.8	65.0	75.9	70.2	85.6	64.9
B. Current Assets ...	37.7	46.5	27.3	46.3	30.6	31.8	21.5	27.7	8.4	35.1
Of which —										
(i) Stocks** ...	36.4	75.1	79.6	51.8	83.2	52.7	44.6	71.2	53.6	21.3
(ii) Liquid Assets** ...	12.6	– 9.2	–19.5	8.2	–20.0	—	27.5	–36.4	–56.0	16.9
(iii) Others** ...	51.0	34.1	39.9	40.0	36.8	47.3	27.9	65.2	102.4	61.7
C. Miscellaneous Assets ...	1.0	1.3	– 1.1	5.4	9.6	3.2	2.6	2.1	6.0	—

§ Excluding bonus issues. † Including bonus issues. * Expressed as percentage of (b).

+ Increase in trade dues and current liabilities, all borrowings other than those from banks, etc.

** Expressed as percentage of B.

TABLE 12

COMBINED BALANCE SHEET OF 1001 SELECTED PUBLIC LIMITED COMPANIES — END OF 1957

(Rs. crores)

Capital and Liabilities		Assets	
A. Paid-up Capital	526	G. Gross Fixed Assets	1241
1. Ordinary	434	14. Land	58
2. Preference	92	15. Buildings	248
B. Free Reserves and Surplus	330	16. Plant and Machinery	829
3. Capital Reserve	51	17. Others	106
4. General and other Reserves	279	18. *Less* Depreciation	492
C. 5. Taxation Reserve	116	H. 19. Net Fixed Assets	749
D. Borrowings	510	I. Stocks and Stores	559
6. From Banks	252	20. Raw Materials	143
7. From Industrial Finance Corporation	14	21. Finished Goods and work-in-progress	279
8. Other Mortgages	103	22. Others	137
9. Debentures	52	J. Receivables	272
10. Others	89	23. Loans and Advances	66
E. 11. Trade Dues and other Current Liabilities	332	24. Book Debts and other Debtor Balances	207
F. 12. Miscellaneous Non-current Liabilities	16	K. Investments	107
		25. Government Securities	21
		26. Semi-Government Securities	—
		27. Industrial Securities	62
		28. Shares of Subsidiary Companies	24
		L. 29. Advance of Income-Tax	50
		M. Other Assets	21
		30. Immovable Properties	1
		31. Miscellaneous Non-current Assets	8
		32. Intangible Assets	11
		N. Cash and Bank Balances	72
		33. Fixed Deposits with Banks	10
		34. Other Bank Balances	54
		35. Cash in Hand	8
13. Total	1831	36. Total	1831

Source: Reserve Bank of India Bulletin, August 1959.

It should be pointed out that unlike in many developed countries, the capital structure of the Indian joint stock companies is very well balanced, the largest amount representing equity capital. Thus, out of Rs. 526 crores of paid-up capital at the end of 1957, Rs. 434 crores or a little over 80 per cent comprised ordinary or equity capital, the rest being preference capital. Debentures formed only about 10 per cent of the paid-up capital. In the U.K., for instance, three-fourths of the paid-up capital is ordinary and one-fourth preference. Debentures form a higher percentage of capital, namely, about 30. In the U.S.A., while the relative share of ordinary and preference capital is more or less the same as in India, debentures constitute a much higher percentage of capital, namely, 75-80. This is perhaps due to the fact that the shareholders do not get any credit for the tax paid by the company, unlike in India (till 1958-59) and the U.K. This is what the Americans call double taxation of dividends.

It is not necessary to review in the same detail the data which the Reserve Bank has published, for the years 1955, 1956 and 1957, of the finances of 333 *private* limited companies (other than financial and Government companies), accounting for 30 per cent of the paid-up capital of all the private companies in the sectors covered. The structure of assets and liabilities and operating results of these companies for 1955, 1956 and 1957 together with some ratios are given in Table 13.

(d) LIFE INSURANCE

The growth of life insurance is yet another important indicator of the growth of savings and supply of funds to the capital market. The statistics are presented in Tables 14 and 15. With the establishment of the Life Insurance Corporation of India, it would appear that statistics relating to life insurance will be available more promptly and more fully than was the case earlier.

In the post-Independence period, life insurance business has recorded a not insignificant progress. The number of *new* policies as well as the sums assured in India have shown, by and large, a steady rise, the former from 486,000 in 1948 to 796,000 in 1955 and the latter from Rs. 135 crores to Rs. 241

TABLE 13

PATTERN OF ASSETS/LIABILITIES AND OPERATING RESULTS OF 333 SELECTED PRIVATE LIMITED COMPANIES — 1955, 1956 AND 1957

(Rs. crores)

		1955	1956	1957
1. Paid-up capital — at the end of the year		59	60	62
2. Free reserves & surplus	„	21	21	21
3. Net worth (1+2)	„	80	81	83
4. Borrowings	„	49	56	57
5. Trade dues and other current liabilities	„	45	52	58
6. Gross fixed assets	„	61	68	76
7. Net fixed assets	„	34	37	41
8. Inventories	„	58	65	69
9. Total assets/liabilities (net)	„	187	206	218
10. Total income during the year		246	286	304
11. Sales	„	201	238	253
12. Profits before tax	„	11	13	14
13. Profits after tax	„	6	6	5
14. Dividends paid	„	4	4	4
15. Profits retained	„	2	2	1
	Percentages*			
Gross profits as percentage of total capital employed		7.2(10.2)	7.7(9.5)	7.8(7.4)
Gross profits as percentage of gross sales		6.7(10.4)	6.7(10.0)	6.7(8.0)
Profits after tax as percentage of net worth		7.3(9.0)	7.3(8.7)	5.8(6.2)
Dividends as percentage of paid-up capital (ordinary shares)		6.1(9.1)	7.1(9.5)	7.2(8.7)

* Figures in brackets give the corresponding percentages in respect of the 1001 *public* limited companies referred to earlier.

TABLE 14

PROGRESS OF LIFE INSURANCE IN INDIA

	1948	1950	1953	1955	1956	1957	1958
I. New Business effected in India							
(A) Number of Policies (000's) ...	486	498	575	796	549	811	955
(B) Sum Assured (Rs. crores) ...	134.6	139.5	156.3	240.5	187.7	277.7	339.1
II. Total Business in Force in India							
(at the end of the year)							
(A) Number of Policies (000's) ...	3025	3280	4167	4516	N.A.	5418	5974
(B) Sum Assured (Rs. crores) ...	724	780	970	1128	N.A.	1374	1584
III. Income and Outgo							
(A) Premium Income (Rs. crores) ...	36.5	41.4	52.2	58.3	37.6†	88.1*	73.1
(B) Other Income ,, ...	8.5	7.9	12.0	15.7	9.4†	19.9*	15.8
(C) Total Income ,, ...	44.9	49.3	64.1	74.0	46.9†	108.0*	88.9
(D) Outgo ,, ...	26.6	29.2	36.6	44.6	31.4†	67.0*	50.7
IV. Income *minus* Outgo (C—D) (Rs. crores) ...	18.4	20.1	27.6	29.4	15.6†	41.0*	38.2
V. Life Insurance Fund at the end of the year (Rs. crores) ...	191.1	224.1	305.7	351.8	380.4§	410.4	447.8
VI. Total Assets at the end of the year‡ (Rs. crores) ...	193.1	227.5	320.7	370.5 (327.9)	414.0§	465.0	504.8

† Relates to the period of 8 months ended August 31, 1956.

* Figures are for the period September 1, 1956 to December 31, 1957.

§ As on August 31, 1956.

‡ Separate figures of assets in respect of life and non-life business are not available prior to 1954; for the year 1955 the figure of assets in respect of life business is given in brackets below the total; figures for 1956 through 1958 relate to assets in respect of life business only.

Sources: The Indian Insurance Yearbooks and Annual Reports of LIC.

TABLE 15

DISTRIBUTION OF ASSETS OF ALL INDIAN INSURANCE COMPANIES — LIC

A. In Crores of Rupees

Type of Investment	End of							Increase (+) or Decrease (—) of column 7 over 5	
	1948	1950	1953	1955	@ 1956	@@ 1957	@@ 1958	Absolute Amount	Percentage
	1	2	3	4	5	6	7	8	9
1. Central & State Government Securities	107.0	117.4	150.4	167.9 (159.5)	204.7	228.1	255.8	+51.1	+24.96
2. Government guaranteed & other approved securities	10.0	11.0	18.8	21.0 (20.7)	30.2	32.5	37.0	+ 6.7	+22.30
3. Foreign Government Securities	2.8	3.9	5.8	7.4 (5.0)	13.2	7.8	9.4	— 3.9	—29.20
4. Shares and Debentures of Companies	24.5	33.2	45.9	59.5 (51.6)	57.7	69.1	76.2	+18.5	+32.03
(a) Ordinary Shares	N.A.	N.A.	19.9	25.3 (20.9)	22.9	32.4	37.9	+15.0	+65.47
(b) Preference Shares	N.A.	N.A.	11.3	14.0 (12.0)	13.7	15.8	16.8	+ 3.2	+23.10

TABLE 15 (Contd.)

	1	2	3	4	5	6	7	8	9
(c) Debentures	N.A.	N.A.	14.7	20.2 (18.7)	21.1	20.9	21.4	+ 0.3	+ 1.46
5. Land & House Property	6.6	9.6	17.6	17.5 (16.8)	19.3	21.4	22.2	+ 2.9	+15.10
6. Mortgages on Property	4.4	7.7	14.6	15.1 (14.6)	15.0	13.9	12.4	— 2.6	—17.38
7. Other Loans	10.3	13.8	25.6	30.5 (29.6)	36.8	38.9	39.8	+ 3.0	+ 8.18
8. Others‡‡	27.6	31.0	42.0	51.7 (30.2)	37.1	53.4	52.1	+15.1	+40.70
Total Assets	193.1	227.5	320.7	370.5 (327.9)	414.0	465.0	504.8	+90.8	+21.92

TABLE 15 (Contd.)

B. Percentage Distribution of Total Assets

Type of Investment	1	2	3	4	5	6	7
1. Central & State Government Securities	55.4	51.6	46.9	45.3 (48.6)	49.4	49.1	50.7
2. Government guaranteed and other approved securities	5.2	4.8	5.9	5.7 (6.3)	7.3	7.0	7.3
3. Foreign Government Securities	1.5	1.7	1.8	2.0 (1.5)	3.2	1.7	1.9
4. Shares and Debentures of Companies	12.7	14.6	14.3	16.1 (15.7)	13.9	14.9	15.1
(a) Ordinary Shares	N.A.	N.A.	6.2	6.8 (6.4)	5.5	7.0	7.5
(b) Preference Shares	N.A.	N.A.	3.5	3.8 (3.7)	3.3	3.4	3.3
(c) Debentures	N.A.	N.A.	4.6	5.5 (5.7)	5.1	4.5	4.3
5. Land & House Property	3.4	4.2	5.5	4.7 (5.1)	4.7	4.6	4.4
6. Mortgages on Property	2.3	2.4	4.6	4.1 (4.5)	3.6	3.0	2.5
7. Other Loans‡	5.3	6.1	8.0	8.2 (9.0)	8.9	8.4	7.9
8. Others‡‡	14.3	13.6	13.1	14.0 (9.2)	8.9	11.5	10.3

Note : Separate figures in respect of life and non-life business are not available prior to 1954; for the year 1955 investments in respect of life business are given in brackets below the totals; figures for 1956 to 1958 relate to life business only.

@ Relate to investments of insurers (life only) whose 'controlled business' was taken over by the Life Insurance Corporation of India and are as on August 31, 1956.

@@ Relate to Life Insurance Corporation of India. ‡ Such as (1) loans on policies (2) stocks and shares and loans other than (1) and (2).

‡‡ Such as (a) Agent's balances, (b) accrued interest, (c) deposits, cash and stamps etc. (d) outstanding premiums etc.

crores; the rise in business in 1954 and 1955 was somewhat of an unhealthy character. Both recorded a substantial fall in 1956, but there was a recovery in 1957, the number of policies being 811,000 and the sum assured being Rs. 278 crores; these rose respectively, to 955,000 and Rs. 339 crores in 1958*, reflecting in part the high tempo of salesmanship of the Life Insurance Corporation (Table 14). More important than the new business is the total of the outstanding business, since a part of the new business may be at the expense of policies which have been paid-up or otherwise ceased to be current. The total number of policies in force in India rose from 3.0 million at the end of 1948 to 6.0 million at the end of 1958; during the same period the total amount of life business in force also more than doubled, from Rs. 724 crores to Rs. 1,584 crores. This gives a per capita insurance of about Rs. 40 which is an extremely low figure, constituting less than one-eighth of per capita income. (The per capita insurance in the U.S. is something like Rs. 15,000 or 150 per cent of per capita income). Low per capita insurance in India is a reflection of not merely low per capita income and saving ability but also of the lack of adequate life insurance salesmanship. Thus, for a population of almost 400 million, the number of life policies outstanding is only of the order of 6 million; it will be borne in mind that many people have more than one policy. (In the U.S. for a population of a little over 170 million the number of policies in force, including group and other policies, was 267 million as of 1958). The annual increase in life fund (which represents the insurance companies' total income less outgo) doubled from Rs. 18.3 crores in 1948 to Rs. 37.4 crores in 1958.

In this study, we are particularly concerned with the pattern of investment of life funds. It has been mentioned earlier that there are fairly rigid statutory requirements regarding investment of life insurance funds in India. The investments are predominantly in Government and quasi-Government securities. In

* It was recently stated that in the first 8 months of 1959 new business completed was running 23 per cent higher than that in the corresponding period of 1958 and that the target of Rs. 415 crores for the whole year was likely to be reached. The Corporation's goal for new business in the last year of its five year plan i.e. 1963, is Rs. 1000 crores.

fact, the bye-laws of some of the insurance companies, in particular the former Oriental Life Insurance Company, required a high percentage of investment in Government securities. The total assets of Indian insurance companies, including non-life companies for which separate data are not available prior to 1954, nearly doubled from Rs. 193 crores in 1948 to Rs. 371 crores in 1955. At the end of 1958, the life assets alone (of the Life Insurance Corporation) amounted to Rs. 505 crores (Table 15). During the 10-year period as a whole, there was no major shift in the composition of life investments. The largest amount was accounted for by Central and State Government securities which rose from Rs. 107 crores in 1948 to Rs. 256 crores. However, as a percentage to total assets, Central and State Government securities recorded a net fall of 4 points from 55 to 51 during this period; the percentage was as low as 45 in 1954 and 1955. On the other hand, shares and debentures recorded a relatively larger increase; the amount increased from Rs. 24 crores to Rs. 76 crores and the percentage from 12.7 to 15.1, the highest being 16.1 per cent in 1955. During the time that the Life Insurance Corporation has been in existence, the holdings of shares, particularly ordinary shares, have risen somewhat fast, from Rs. 23 crores to Rs. 38 crores or by 65 per cent as compared to the 22 per cent rise in total assets during the same period. Recently, the Chairman of the Corporation stated that there was shortage of 'blue chips' i.e. good scrips, but for which investment in shares would have been larger. The LIC's investment operations now have profound effect on stock market sentiment and stock prices. The industrywise distribution of the LIC's holdings of shares (ordinary and preference) and debentures, as at the end of 1958, is given in Table 16.

TABLE 16

DISTRIBUTION OF THE LIC'S INVESTMENTS AMONG IMPORTANT INDUSTRIES

Industries	Amount invested (Rs. crores)	Percentage to total
1. Electricity ...	8.74	11.5
2. Engineering ...	8.69	11.4
3. Cotton ...	7.59	10.0
4. Iron and Steel ...	5.67	7.4

Industries		Amount invested (Rs. crores)	Percentage to total
5.	Jute ...	4.19	5.5
6.	Cement ...	4.31	5.7
7.	Paper and Pulp ...	3.11	4.1
8.	Banks ...	2.86	3.8
9.	Coal ...	1.97	2.6
10.	Sugar and Breweries ...	1.71	2.2
11.	Insurance ...	1.61	2.1
12.	Shipping and other Transport ...	1.49	2.0
13.	Plantations ...	1.42	1.9
14.	Chemicals and Pharmaceuticals	1.28	1.7
15.	Others ...	21.53	28.3
	Total ...	76.17	100.0

Besides, the Corporation has been engaging in underwriting activity. The particulars for the period September 1956 — December 1957 and for the year 1958 are as under:

TABLE 17

UNDERWRITING OPERATIONS OF LIC

	Total No. of issues underwritten	Debentures and Loans (Rs. crores)	Preference Shares (Rs. crores)	Ordinary Shares (Rs. crores)	Total Amount (Rs. crores)
Sep. 1956—Dec. 1957	21	0.23	1.20	0.44	1.87
1958	19	2.21	0.43	0.10	2.74
Total	40	2.44	1.63	0.54	4.61

Underwriting is of special significance in respect of share capital, especially ordinary capital, but the Corporation's underwriting of ordinary shares is the smallest. Naturally, the Corporation has chosen to proceed cautiously. Information is not available as to the amount, if any, which the Corporation had to take up in fulfilment of the underwriting commitments. It is not unlikely that in any event the Corporation would have liked to acquire for its portfolio the issues which it agreed to underwrite.

Mortgages on property recorded very little net change percentagewise, at 2.5; land and house property investments are also relatively unimportant, accounting for 4.4 per cent.

The pattern of assets of Indian insurance companies has remained relatively stable over the years, and thus there has been no disturbance to the capital and money markets from this source, unlike in some countries, particularly the U.S.A. In foreign countries, generally speaking, Government securities do not occupy the important place which they do in India in the assets structure of insurance companies. The two items which have shown substantial rise and occupy an important place in the assets structure are mortgages and shares and debentures. In the U.K., for example, British Government and other Government securities together account for about 30 per cent of the total assets now, as compared to almost 50 per cent about a decade back (Table 18). Stocks and debentures together account for almost 40 per cent of total assets, as compared to about 30 per cent in 1947, the rise being mostly in ordinary shares. Mortgages have also risen substantially, the percentage to total investments going up from 6 to 14. In the U.S.A., except during the last war, Government securities have not occupied an important place in the assets pattern. In the War years, the life companies bought substantial amounts of Government securities, which in fact increased more than the increase in total assets. Government securities rose from $6 billion in 1940 to $21 billion in 1945, or from 18.7 per cent to 45.9 per cent of total assets (Table 18). But, in the post-war years, there has been a marked shift away from Government securities to mortgages and industrial bonds and shares. In the result, both the Government securities market and stock market have been profoundly influenced by the operations of life insurance companies. Thus, whereas total assets of life companies rose from $45 billion in 1945 to $108 billion in 1958, U.S. Government securities holdings fell from $21 billion to $7 billion in 1958; percentage-wise, U. S. Government securities came down from 45.9 to 6.7! On the other hand, mortgages rose from $7 billion to $37 billion or from 14.8 per cent to 34.4 per cent. Bonds (rail-road, public utility and industrial) rose from $10 billion to $43 billion or from 22.5 per cent to 40.2 per cent. The rise in holdings of

TABLE 18

DISTRIBUTION OF LIFE INSURANCE ASSETS/INVESTMENTS

A. U.K.

(£ million)

	British Government Securities	Commonwealth and Foreign Government Bonds	Debentures and Preference Shares	Ordinary Shares	Mortgages	Property & Ground Rents	Other Investments	Total
1. 1947	1,003	246	521	272	158	149	211	2,561
	(39.16)	(9.61)	(20.34)	(10.62)	(6.17)	(5.82)	(8.24)	(100.00)
2. 1958	1,235	459	1,188	1.021	753	494	378	5,528
	(22.34)	(8.30)	(21.49)	(18.47)	(13.62)	(8.94)	(6.84)	(100.00)
3. Increase	232	213	667	749	595	345	167	2,967
	(7.82)	(7.18)	(22.48)	(25.24)	(20.05)	(11.63)	(5.63)	(100.00)
4. (3) as % of (1)	23	86	128	275	376	232	79	115

Note: Figures in brackets represent percentages of constituent items to total investments.
Source: Financial Times, October 26, 1959.

TABLE 18 (Contd.)

B. U.S.A.

(S billion — i.e. thousand million)

	U.S. Government Securities	Foreign Govt. Bonds	State, Provincial & Local Bonds	Rail Road Pub. Utility, Indl. & Misc. Bonds	Stocks	Mortgages	Real Estate	Others	Total
1. 1940	5.8 (18.7)	0.3 (1.0)	2.4 (7.8)	8.6 (28.1)	0.6 (2.0)	6.0 (19.4)	2.1 (6.7)	5.1 (16.3)	30.8 (100.0)
2. 1945	20.6 (45.9)	0.9 (2.1)	1.0 (2.3)	10.1 (22.5)	1.0 (2.2)	6.6 (14.8)	0.9 (1.9)	3.7 (8.3)	44.8 (100.0)
3. 1950	13.5 (21.0)	1.1 (1.7)	1.5 (2.4)	23.3 (36.4)	2.1 (3.3)	16.1 (25.1)	1.4 (2.2)	5.0 (7.9)	64.0 (100.0)
4. 1955	8.6 (9.5)	0.4 (0.4)	2.7 (3.0)	36.1 (39.9)	3.6 (4.0)	29.4 (32.6)	2.6 (2.9)	7.0 (7.7)	90.4 (100.0)
5. 1958	7.2 (6.7)	0.3 (0.3)	3.5 (3.3)	43.2 (40.2)	4.1 (3.8)	37.1 (34.4)	3.4 (3.1)	8.8 (8.2)	107.6 (100.0)
6. Increase (+) or decrease (—) of (5) over (2)	−13.4	− 0.6	+ 2.5	+ 33.1	+ 3.1	+ 30.5	+ 2.5	+ 5.1	+ 62.8
7. (6) as % of (2)	−65.0	−66.7	+250.0	+327.7	+310.0	+462.1	+277.8	+137.8	+140.2

Note: Figures in brackets represent percentages of constituent items to total investments.
Source: Institute of Life Insurance: *Fact Book*, 1959.

stocks (*i.e.* shares) was comparatively small, from \$1.0 billion to \$4.1 billion (2.2 to 3.8 per cent).

(e) PROVIDENT FUNDS

Comprehensive and up-to-date data in respect of provident funds are not available. Provident fund net collections of the Central and State Governments now amount to about Rs. 25 - 30 crores per annum. These are not invested separately, but merged with other funds of Government, constituting Unfunded Debt. Even as regards the Employees' Provident Fund Scheme, under the Act of 1952, the investments are made wholly in Government securities, including small savings, as already mentioned. The Employees' Provident Fund Scheme is now in operation in about 40 industries, covering about 7,000 establishments and 2.5 million workers. An idea of the increased flow of investible funds in respect of establishments coming under the scope of the 1952 Act (but excluding the exempted establishments which manage the funds separately) is given by the fact that in 1957-58 a sum of Rs. 11.05 crores was invested as compared to Rs. 7.72 crores in 1956-57, Rs. 5.51 crores in 1955-56 and Rs. 5.75 crores in the two years 1952-53 and 1953-54 together. At the end of March 1958, total assets of the Employees' Provident Fund Scheme, including assets received by it as past accumulations of some units, amounted to Rs. 44 crores. Recent data indicate that the accumulated sum of all Provident Funds, inclusive of exempted factories, stood at Rs. 133 crores as at the end of February 1959. In respect of the Coal Mine Provident Funds, the total amount outstanding as of March 31, 1958 was Rs. 12.98 crores (book value), of which Rs. 10.61 crores were held in Government of India securities. The above figures relating to non-Government Provident Funds are incomplete. We may estimate the accumulation of private funds from the figures of wage and salary payments of joint stock companies (from the Reserve Bank's studies of company finances) and other institutions, such as banks and insurance companies. It would appear that non-Government provident fund accumulations, including employers' contributions, is now running at the rate of something like Rs. 50 crores per annum. Thus, total provident fund collections, including those of Government employees, may be

placed at Rs. 75 - 80 crores per annum. With increasing coverage and growth in industrial employment following rapid industrialisation of the country, the annual collection should show a further increase, though the investment policy of the provident funds is such that the private sector of industry would not derive any direct benefit from this growth.

Some broad details of the investment pattern of provident funds, other than those directly managed by the Employees' Provident Fund Scheme, are available from a survey conducted by the National Sample Survey. The Survey which related to the position as of end-March 1954 covered 216 recognised provident funds of local bodies, semi-Government and private institutions and factories exempted from the Employees' Provident Funds Act, 1952, at Bombay, Calcutta, Madras, Kanpur, Coimbatore and Jamshedpur. According to the Survey, total investments of these funds amounted to Rs. 24.67 crores, of which exempted factories held Rs. 7.64 crores (31 per cent), local bodies Rs. 8.32 crores (34 per cent), semi-Government and private institutions Rs. 8.62 crores (35 per cent). Of the total, Rs. 11.83 crores or 49 per cent were held in Government securities, Rs. 10.74 crores or 43 per cent in non-Government securities and Rs. 2.1 crores or 8 per cent in National Savings Certificates.

(f) INVESTMENT TRUSTS

Investment trusts are yet another important institutional agency for the mobilisation and channelling of savings in the Western countries, but in India these have hardly developed. In India, some interest in the investment trusts was stimulated in the 1930's, subsequent to the setting up of the Central Banking Enquiry Committee. Another factor was the grant in 1933 by the Government of India of exemption to investment trust companies from payment of super-tax in respect of income derived from dividends of any other company which had paid or would pay super-tax in respect of profits, out of which such dividends were paid. Investment trust companies, it may be mentioned, continue to enjoy this exemption. The Second World War provided a further stimulus, a number of managing agents evincing interest in the establishment of investment trust companies. There is

at present a fairly large number of companies which are registered as investment and trust companies (separate data not being available for investment trusts only) but the vast majority of them do not perform the functions of a true investment trust. Most of them are connected with the management of the funds of a few rich individuals and families or of managing agents for investment in the companies controlled by them, and are in the nature of holding companies rather than public trusts. Thus, Birds Investments, formed in 1936 at Calcutta, was intended to invest funds mainly in concerns in which the managing agency houses Bird & Co. and F. W. Heilgers & Co. were interested. The company has a paid-up capital of Rs. 44 lakhs and investments of Rs. 65 lakhs. Likewise, the Clive Row Investment Holding Company was formed in 1946 mainly with a view to investing funds in shares and debentures of companies under the management of the firm Andrew Yule & Co. This company has a paid-up capital of Rs. 1.39 crores and investments of Rs. 2.06 crores. Again, Eastern Investments, registered in 1927, was formed by the late Lord Cable to hold some of his private investments and since his death the shares of the company have been held by the trustees of his estate. In May 1946 a substantial block of shares were placed in the market. The investments have been made mostly in the companies under the management of the Bird-Heilgers group.

At the end of March 1957, there were 619 investment and trust companies, with a paid-up capital of Rs. 37 crores as compared to 465 companies with a paid-up capital of Rs. 18 crores at the end of March 1948 (Table 19). The paid-up capital of these companies constituted 3.5 per cent of the paid-up capital of all companies at work in India. About two-fifths of them only are public limited companies, accounting for three-fourths of the paid-up capital. Data on size distribution, available as of March 1953, indicate that the majority of them are very small; 332 out of 616 companies had paid-up capital below Rs. 1 lakh and 131 between Rs. 1 lakh and Rs. 5 lakhs each. Only 9 companies had paid-up capital of Rs. 50 lakhs and above. For the Indian capital market, investment trusts, therefore, are of little significance.

TABLE 19

INVESTMENT AND TRUST COMPANIES AT WORK IN INDIA

As at the end of	Number of Companies	Paid-up capital (Rs. crores)	As percentage of total paid-up capital of all companies at work for that year
1920-21	40	6.75	4.1
1935-36	122	15.22	5.0
1937-38	141	9.05	3.2
1938-39	148	10.16	3.5
1945-46	336	15.94	3.8
1946-47	441	14.29	3.0
1947-48	465	17.68	3.1
1948-49	499	18.27	2.9
1949-50	615	24.35	3.4
1950-51	610	29.63	3.8
1951-52	617	29.67	3.5
1952-53	616	30.02	3.3
1953-54	570	30.46	3.2
1954-55	619	30.44	3.1
1955-56	626	36.90	3.6
1956-57	619	37.19	3.5

Two prominent investment trusts which may be said to correspond rather closely to the investment trusts abroad are the *Industrial Investment Trust* and the *Investment Corporation of India.* The Industrial Investment Trust was sponsored in 1933 and is managed by the well-known firm of stock and finance brokers, Premchand Roychand & Sons. This trust had at the end of December 1958 investments totalling Rs. 1.27 crores, spread over more than 200 securities. The Investment Corporation of India (established in 1937) is associated with India's leading business house of Tatas. At the end of June 1958, this Corporation had investments totalling Rs. 3.52 crores, distributed over as many as 400 securities. This trust company has been strengthened further, consequent upon the amalgamation with it of the Oriental Government Security Life Assurance Co. Ltd., following the nationalisation of life insurance business in India in 1956. In terms of the scheme of amalgamation, 75,000 ordinary shares of the Corporation (of Rs. 100 each, fully paid) were allotted to the shareholders of the Oriental Company. At the same time, the Corporation paid, in terms of the scheme, a sum of Rs. 46.8 lakhs to shareholders of Oriental Company who opted for payment in cash, at the rate of Rs. 4,300 per Oriental

share. An analysis of the investments of these two companies shows that the bulk of the investments is in ordinary shares. This is probably true of most of the investment and trust companies.

TABLE 20

INVESTMENTS OF TWO LEADING INVESTMENT TRUSTS

(Percentage distribution of total investments)

	Industrial Investment Trust as of December 31, 1958	Investment Corporation of India — as of June 30, 1958
Government Securities	2.32	0.37
Debentures	2.14	0.06
Preference Shares	15.62	11.44
Ordinary Shares	79.92	88.13
	100.00	100.00

Several committees which have considered the question of promotion of savings and investment in the country, in particular the Committee on Finance for the Private Sector (Shroff Committee) have recommended the establishment of investment trusts, especially unit trusts. Unit trusts should prove helpful and there is a case for Government initiative and assistance, in particular through exemption of income-tax also. This matter is considered in somewhat greater detail in the concluding chapter.

(g) GOVERNMENT BORROWING

It was mentioned earlier that the Government is a very important source of demand for capital funds. In the pre-war years, the magnitude of Government borrowing was rather small. In the war years, of course, they assumed large dimensions. After an interval of 7-8 years, Government borrowing has again been taking place on a large scale, with the quickened tempo of the Five Year Plans since 1954-55. Table 21 gives the net sums raised by the Central Government and State Governments annually since 1930-31. It will be seen that in the last 6 years the

TABLE 21

MARKET BORROWINGS OF THE GOVERNMENT OF INDIA AND STATE GOVERNMENTS SINCE 1930

(Crores of Rs.)

	Central Government			State Governments			Total net borrowings (3+6)
	New loans (cash subscriptions)	Repayment in cash of maturing loans	Net borrowings (1—2)	New loans (cash subscriptions)	Repayment in cash of maturing loans	Net borrowings (4-5)	
	1	2	3	4	5	6	7
1930-31	12.9	7.5	+ 5.5	—	—	—	+ 5.5
1931-32	14.9	5.3	+ 9.6	—	—	—	+ 9.6
1932-33	18.5	11.0	+ 7.5	2.6	4.1	— 1.5	+ 6.0
1933-34	10.1	21.6	— 11.5	3.3	1.9	+ 1.4	— 10.1
1934-35	13.9	11.9	+ 2.0	—	—	—	+ 2.0
1935-36	5.1	17.5	— 12.4	—	9.3	— 9.3	— 21.7
1936-37	12.0	—	+ 12.0	2.0	0.1	+ 2.0	+ 14.0
1937-38	—	—	—	4.6	—	+ 4.6	+ 4.6
1938-39	6.3	5.9	+ 0.5	2.5	—	+ 2.5	+ 3.0
1939-40	1.4	11.8	— 10.5	4.8	—	+ 4.8	— 5.7
1940-41	37.5	6.0	+ 31.6	3.9	—	+ 3.9	+ 35.5
1941-42	50.1	5.2	+ 44.9	—	—	—	+ 44.9
1942-43	43.7	—	+ 43.7	7.8	—	+ 7.8	+ 51.5
1943-44	204.8	2.2	+202.5	7.8	—	+ 7.8	+210.3
1944-45	207.7	—	+207.7	13.3	2.7	+ 10.6	+218.3
1945-46	329.6	25.9	+303.7	9.1	0.1	+ 9.0	+312.7

TABLE 21 (Contd.)

(Crores of Rs.)

	Central Government			State Governments			Total net borrowings (3+6)
	New loans (cash subscriptions)	Repayment in cash of maturing loans	Net borrowings (1—2)	New loans (cash subscriptions)	Repayment in cash of maturing loans	Net borrowings (4-5)	
	1	2	3	4	5	6	7
1946-47	115.8	78.2	+ 37.6	6.9	0.1	+ 6.8	+ 44.4
1947-48	20.8	34.0	— 13.2	0.4	0.1	+ 0.3	— 12.9
1948-49	20.0	62.3	— 42.3	2.0	—	+ 2.0	— 40.3
1949-50	15.0	31.4	— 16.4	6.0	0.7	+ 5.3	— 11.1
1950-51	7.6	17.6	— 10.0	9.1	—	+ 9.1	— 0.9
1951-52	12.8	49.2	— 36.4	11.5	—	+ 11.5	— 24.8
1952-53	—	—	—	15.8	2.9	+ 12.9	+ 12.9
1953-54	23.4	63.3	— 39.8	37.0	0.6	+ 36.4	— 3.5
1954-55	158.2	48.0	+110.1	2.5	2.0	+ 0.5	+110.6
1955-56	45.7	12.4	+ 33.3	52.9	4.2	+ 48.7	+ 82.0
1956-57	77.2	—	+ 77.2	66.5	3.0	+ 63.5	+140.7
1957-58	91.1	25.2	+ 65.9	8.6	3.8	+ 4.8	+ 70.7
1958-59	192.5	11.6	+180.9	49.2	3.2	+ 46.0	+226.9
1959-60*	139.2	32.3	+106.9	66.9	0.6	+ 66.2	+173.1

* Provisional.

volume of Government borrowing has shown a marked rise. During the First Plan period as a whole, the total amount raised, at Rs. 177 crores, was higher than the target fixed at the commencement of the Plan (Rs. 115 crores), though this was raised in the last two years only. The actual absorption of Government debt by the market seems to have been even larger, since during this period the Reserve Bank made net sales of securities out of its portfolio. In the Second Plan period also, during the first four years, the total sum raised at Rs. 611 crores is slightly higher than the average estimated at the beginning of the Plan period, of Rs. 140 crores per annum. A substantial part of this, say of the order of Rs. 250 crores, is however due to a special factor, namely, the investment of P.L. 480 counterpart deposits. Even allowing for this, the Government borrowing is fairly large now, of the order of Rs. 90 - 100 crores per annum.

An interesting post-war development is the substantial scale of borrowing by the State Governments. In a planned economy like India's, wherein the resources of the Union Government and the State Governments are fully integrated, what matters is the aggregate mobilisation of funds regardless of the fact whether the money is raised on the Central Government's account or the State Government's account. But the fact remains that in the scheme of mobilisation the States can play a very important role insofar as they can tap local resources much more effectively than the Central Government. In this connection, it may be interesting to point out that the technique of State borrowing was given a reorientation by India's elder statesman, Shri C. Rajagopalachari, when he was the Chief Minister of Madras some years ago. He utilised the entire administrative set-up of the State for making the loan programme a marked success. There was undoubtedly a certain amount of compulsion, which was vehemently criticised by the stock-broking community and the financial press. It is also a fact that after the loan campaign was over, there developed a selling pressure by unwilling holders who had, to a not inconsiderable extent, borrowed from banks for the purpose. All the same, the Rajaji technique is inherently sound for an economy that has to develop rapidly. We seem to dislike compulsion in respect of Government borrowing but we forget that in other fields, especially life insurance,

there is a great deal of compulsion or pressure by the insurance agents and often times people buy insurance policies to oblige a friend or a relative. But in the long run, the policy-holders do realise the immense benefit of life insurance. As a matter of fact, even subscriptions to the capital issues of joint stock companies are not free from pressures and special influences of all sorts. It would, therefore, appear that there is nothing objectionable in the Rajaji technique. On the other hand, it has positive merits and when we are contemplating methods of compulsion in other ways for raising funds for the successful prosecution of progressively larger Plans, the Rajaji technique should be regarded as a step in the right direction.

Conditions in India are very favourable for Government borrowing. The important thing is that institutional investors, in particular the Life Insurance Corporation and provident funds, are compelled to invest in Government securities. These two agencies are bound to grow in importance as mobilisers of savings of the community and therefore an increasing support to the Government securities market is assured. Besides, the growth of the banking sector would also mean marked support to the Government securities market. Further, although investment in stocks and shares is growing, there are many people who prefer to put their savings in Government securities. Also, thousands of private trusts have to put in their funds predominantly in Government securities.

The total outstanding marketable Rupee debt (excluding Treasury bills) of the Government of India amounted to Rs. 2181 crores (including Rs. 300 crores held by the Reserve Bank, consequent on the funding of Treasury bills of the same amount in July 1958) at the end of March 1959, having risen from Rs. 1513 crores at the end of March 1948. In the same period, the total of marketable debt of the State Governments rose from Rs. 50-60 crores to Rs. 357 crores.* Thus, the face value of Government debt is much larger than the face value of the corporate securities. The maturity pattern of the Indian public debt is harmonious, with good spread among various maturity ranges, the position as at the end of March 1959 being as under (excluding the special issue of Rs. 300 crores for funding).

* Including zamindari abolition bonds.

TABLE 22

MATURITY PATTERN OF INDIAN PUBLIC DEBT

(Percentages)

	Upto 5 years	5—10 years	10—15 years	Over 15 years	Undated	Total
Central Government Securities ...	38.3	31.7	11.4	4.9	13.7	100.0
State Government Securities ...	23.6	37.0	20.4	19.0	—	100.0

We do not have comprehensive data on the ownership of public debt, though the available data do not compare unfavourably with many developed countries with the exception of the U.S.A. In the July 1956 issue of the *Reserve Bank of India* Bulletin, some provisional estimates were given regarding the ownership of *Central* Government rupee loans.

Recent data on ownership of the Central and State Government loans together, in respect of some important categories are given below; the data relate to different dates, though the holdings of two important categories, namely, commercial banks and Life Insurance Corporation, relate to the same date, namely, December-end, 1958. The Reserve Bank's holdings are as of the end of March 1959.

TABLE 23

OWNERSHIP OF GOVERNMENT DEBT IN INDIA — MARKETABLE LOANS

Category	Date	Amount (Rs. Crores)
Reserve Bank of India	March 1959	221*
Commercial banks	December 1958	675 (103)**
Co-operative banks	June 1957	56
Life Insurance Corporation	December 1958	256 (55)
Provident funds	,,	125
Joint stock companies (1001 cos.)	End of 1957	21

TABLE 23 (Contd.)

Category	Date	Amount (Rs. Crores)
Local authorities	March 1958	45 (9)
Non-residents	March 1955	63
Government (Central and State)		200
	Total of above	1662
Total market loans outstanding at end of March 1959:		
(a) Central Government		1881*
(b) States		357
Total		2238

* Excluding the special issue of Rs. 300 crores.
** Figures in brackets relate to State Government loans.

It will be seen that commercial banks constitute the largest holders, with 30 per cent; the Life Insurance Corporation comes next with 11 per cent. The Reserve Bank is the third largest holder, accounting for 10 per cent of the total marketable loans. Recent data are not available about the holdings of Central and State Governments. In the 1956 estimate given in the *Reserve Bank Bulletin* the total holdings of Central Government securities by the Central and State Governments together were of the order of Rs. 200 crores. It is possible that since then there may have been some disinvestment. On the other hand, that estimate did not include holdings of State Government loans. It may, therefore, not be wrong to put the estimate of Government holdings of Central and State Government securities at the same figure as at the end of March 1956. From the budget papers, it would appear that the Central Government's holdings were small at about Rs. 7.50 crores. Data published in the State Government Gazettes regarding the State Governments' holdings of securities kept with the Reserve Bank also support the above estimate of Rs. 200 crores. Thus, roughly two-thirds of the outstanding loans would be accounted for by Government and institutional investors. In foreign countries also institutional investors predominate.

(h) BORROWING OF LOCAL AUTHORITIES

The magnitude of borrowing by the local authorities (that is, Port Trusts, City Corporations and Municipalities) is very small in relation to that of the Central and State Governments. Further, the borrowing operations of the local authorities are regulated by Government and the payment of interest and the repayment of loans are guaranteed by Government, though only the securities issued by the Port Trusts and the Municipal Corporations at Bombay, Calcutta and Madras have the status of trustee securities. Usually, the rate of interest offered on municipal loans is only slightly ($\frac{1}{4}$-$\frac{1}{2}$ per cent) higher than that on Central and State Government loans. In the last 2 years, the Reserve Bank of India has collected and published valuable data on the borrowings and investments of local authorities (vide *Reserve Bank of India Bulletin*, April 1958 and February 1959). The coverage for the period 1951-57 and for 1957-58 is somewhat different, but this applies mainly to the smaller municipalities and so we may take it that the data presented in Table 24 are quite comparable. It will be seen that, as in the case of the Central Government, the net amount borrowed has shown fluctuations. Also, the bulk of the borrowing is accounted for by the City Municipal Corporations, Bombay being the most important. Port Trusts, on the other hand, have made net repayment, on account of their comfortable financial position.

In the whole of the First Plan period, the local authorities (included in the Reserve Bank survey) raised a net sum of Rs. 9.32 crores from market borrowings (including some external borrowing), the largest amount of Rs. 3.52 crores being in the year 1951-52. In the years 1956-57 and 1957-58 their borrowings amounted to Rs. 1.16 crores and Rs. 3.67 crores, respectively. The City Municipal Corporations raised as much as Rs. 11.5 crores in the period 1951-56 and Rs. 5.13 crores in the two years 1956-58.

The outstanding debt of the local authorities (included in the Reserve Bank survey), in the form of marketable loans, amounted to Rs. 89 crores at the end of March 1958 as compared to Rs. 68 crores at the end of March 1951; of this, the City Corporations accounted for Rs. 56 crores and the Port Trusts Rs. 31

crores, as at the end of March 1958. The average maturity of the debt of the local authorities is much longer than that of Central and State Governments. Thus, at the end of March 1958, 37 per cent of the debt was in the group over 15 years and 17 per cent in the group 10-15 years, the corresponding figures for the Central Government being 21 and 10, respectively.

TABLE 24

BORROWINGS AND DEBT OF LOCAL AUTHORITIES

(Rs. Crores)

Year*	Net Borrowing	Outstanding marketable debt at the end of the year
1951-52	3.52	71.22
1952-53	0.08	71.32
1953-54	3.05	74.38
1954-55	— 0.65	73.74
1955-56	3.33	77.08
1956-57	1.16	78.24
1957-58	3.67	89.05

* For the period 1951-57, the coverage is 4 Port Trusts, 11 City Corporations and 39 Municipalities; for 1957-58, 4 Port Trusts, 13 City Corporations and 43 Municipalities.

(i) SMALL SAVINGS

Although small savings schemes sponsored by the Government of India do not contribute directly to the resources of the capital market, it would be useful to make a brief reference to the subject in view of their great potentiality as a source of funds to the Government for economic development. In an under-developed country where the per capita incomes are very low, any development on a massive scale can only come as a result of the saving, voluntary or involuntary, of the common man. The small savings effort got an impetus during World War II and there has been further marked progress in the post-war years as part of planned development. The small savings schemes offered by the Government are quite varied to suit the requirements of the different types of investors. These are (i) the post office savings bank

deposits, (ii) 12-year National Plan Savings Certificate, which is a cumulative type of security, payment of interest being made only at the time of re-payment of principal, the rate of interest rising with the maturity of the Certificate, (iii) the Treasury Savings Deposit Certificate on which interest is paid every year, the redemption price being below par for premature encashment, (iv) the Annuity Certificate which is at present of the 'immediate' type, running for a period of 15 years and (v) the Cumulative Time Deposit Scheme, introduced in January 1959, by which monthly payment of a fixed sum for a period of 5 years or 10 years will be paid off with interest at the end of the fixed period. Of the above, the post office savings bank deposit system is the oldest, dating from as far back as 1833. The savings certificates in one form or the other have been in existence from 1916. The Treasury Savings Deposit Certificate was introduced in February 1951 and the annuity scheme in July 1954.

The annual collections of small savings in the pre-war years were rather small, averaging less than Rs. 7.5 crores per annum during the decade 1929-39. During the post-war years, the net realisation of small savings has been much larger in money terms, though to a not insignificant extent the rise in net receipts is due to general inflation and rise in money incomes. In the First Plan period as a whole, total collections amounted to about Rs. 240 crores or an annual average of Rs. 48 crores; net collections rose from Rs. 33 crores in 1950-51, the pre-Plan year, to Rs. 68 crores in 1955-56, the last year of the First Plan (Table 25). The largest amount was raised in the form of postal savings bank deposits, which fetched a little over Rs. 100 crores. A somewhat smaller sum was raised through Savings Certificates, while Treasury Savings Deposit Certificates accounted for Rs. 36 crores. It is interesting to note that in the First Plan period the net receipts under small savings considerably exceeded those from market loans.

During the Second Plan, the target of net receipts through small savings schemes was fixed at Rs. 500 crores or an annual average of Rs. 100 crores. The performance, however, has been somewhat disappointing. As compared to Rs. 68 crores in the year 1955-56, collections in 1956-57, the first year of the Second Plan, declined to Rs. 59 crores; they rose to about Rs. 70

TABLE 25

NET RECEIPTS UNDER PRINCIPAL ITEMS OF SMALL SAVINGS

(Rs. Crores)

Year	Post Office Savings Bank Deposits	Certificates @	Treasury Savings Deposit Certificates	15-Year Annuity Certificates	Total Net Receipts
1928-29	1.82	1.60	—	—	3.42
1933-34	8.78	8.07	—	—	16.85
1938-39	4.38	0.64	—	—	3.74
1939-40 to 1945-46 (Annual Average)	4.73	17.22	—	—	21.95
1948-49	19.78	10.15	—	—	29.93
1949-50	15.19	11.00	—	—	26.19
1950-51	16.26	11.86	5.31	—	33.43
1951-52	12.83	12.63	13.08	—	38.54
1952-53	17.83	14.97	7.25	—	40.05
1953-54	14.26	17.16	6.47	—	37.90
1954-55	24.60	25.00	5.04	0.54	55.18
1955-56	36.97	26.95	4.10	0.41	68.43
1956-57	28.65	26.94	3.03	0.37	58.99
1957-58	17.41	45.96	4.77	0.55	68.69
1958-59	13.01	52.22	5.20	0.54	70.97*
Outstanding as at the end of March 1959: **					
(i)	226.92	257.43	54.25	2.41	541.01
(ii)	357.72	362.73	55.67	—	776.12

@ Include National Savings Certificates (12-year, 7-year and 5-year), 12-Year National Plan Savings Certificates, 10-Year National Plan Certificates, Post Office Cash Certificates, Defence Savings Bank Deposits and Defence Savings Certificates.

* The figure has since been revised to Rs. 79.70.

** (i) Exclude Indian Union's share of the pre-Partition liabilities.
(ii) Include Indian Union's share of pre-Partition liabilities.

crores in 1957-58 and further to about Rs. 80 crores in 1958-59. It is, however, likely that over the years small savings collections will show a substantial rise. Since the middle of 1957, the State Governments have intensified their efforts to mobilise such savings. The net collection of small savings are shared between the Central and the State Governments since 1952 on an agreed formula, which has undergone several changes since then. According to the formula obtaining in 1957-58, States were entitled to get loans equal to two-thirds of the net collection made in their respective areas provided no market loan was issued by them. If any State floated a market loan during the year, one-third of its borrowing from this source was to be set off against the State's share of small savings. In June 1958, this formula was revised allowing States to retain their entire market borrowings and in addition receive two-thirds of the net collections from small savings in their own areas.

Very little information is available about the pattern of ownership of small savings. It is probable that in the case of the Treasury Savings Deposit Certificates, the average holding is rather large, of the order of a few thousands of rupees; that is to say, the Treasury Savings Deposit Certificates may not, strictly speaking, be regarded as a small savings medium. The postal savings bank accounts, however, constitute really the small man's savings medium. There has been a gratifying increase in the number of postal savings bank accounts as well as the average deposit per account. The number of accounts increased from 3.15 million at the end of March 1948 to 6.38 million at the end of March 1957, a rise of 103 per cent. The outstanding deposit rose by 151 per cent to Rs. 322 crores, with the result that the average amount per deposit increased by about 25 per cent from Rs. 406 to Rs. 504. The postal savings banks are being used not only for saving but also as ordinary deposit banks. There is nothing wrong in this, insofar as it contributes to the growth of banking and savings habit. Thus, total deposits (including accrued interest), which amounted to Rs. 52 crores in 1938-39, rose to Rs. 194 crores for the Indian Union alone in 1956-57. In the same period, total withdrawals rose from Rs. 47 crores to Rs. 165 crores. During the last three years or so, the relative importance of postal savings deposits in the small savings scheme has been fast declining.

TABLE 26

DISTRIBUTION OF DEPOSITS OF SCHEDULED BANKS

(Amount in crores of rupees)
(Number of accounts in lakhs)

End of	Total		Demand		Savings		Time	
	No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount
1949	32.4	826.4	10.7	478.24 (57.9)	18.3	134.06 (16.2)	3.3	214.11 (25.9)
1951	32.3	821.62	10.2	456.31 (55.5)	19.1	135.35 (16.5)	3.0	229.96 (28.0)
1955	37.2	993.65	10.2	497.03 (50.0)	22.7	162.53 (16.4)	4.3	334.09 (33.6)
1956	40.2	1074.81	10.8	522.21 (48.6)	24.6	183.65 (17.1)	4.8	368.95 (34.3)
1957	43.9	1347.61	10.6	566.25 (42.0)	27.4	201.98 (15.0)	5.9	579.38 (43.0)
1958	48.7	1541.33	11.2	550.93 (35.7)	30.3	221.97 (14.4)	7.2	768.43 (49.9)

Note:— Figures in brackets are percentages to total amount.

Source: Reserve Bank of India Bulletins.

(j) SAVINGS AND TIME DEPOSITS OF BANKS

The savings bank deposits of the commercial banks have also shown a gratifying increase in recent years. Between December 1949 and December 1958, the number of savings bank accounts of the *scheduled* banks rose by about 65 per cent from 1.83 million to 3.03 million; the savings bank deposits also rose substantially to the same extent, from Rs. 134 crores to Rs. 222 crores (Table 26, which also gives figures of demand and time deposits). The average deposit per account in 1958 at Rs. 733 was the same as in 1949. This average per account is substantially higher than the average for postal savings bank account. This is not surprising since scheduled banks are mostly confined to urban areas whereas the postal savings accounts have a much wider coverage. The number of savings bank accounts of scheduled banks also far outnumber current accounts, which at the end of 1958 were of the order of 1.1 million. Time deposits have also been recording a rapid rise, both in respect of the number of accounts and the total amount, though the rise in 1957 and 1958 contains an extra-ordinary item, namely, deposits of U.S. Government of the counterpart funds of P.L. 480 imports. These may be put around Rs. 225 crores.* In the last few years, a number of banks have been issuing cash certificates, generally of three to five years' maturity, carrying an interest rate of 4 - $4\frac{1}{4}$ per cent in the case of the bigger banks.

This concludes the review of the statistics relating to the capital market generally. The statistics will confirm the view expressed earlier that the Indian capital market has been broadening rather significantly and the volume of savings is showing a generally steady improvement though there is perhaps no perceptible rise in the ratio of saving to national income, which is so vital for the prosecution of ambitious Plans, which the country has embarked upon.

* On the assumption that the deposits under 'others', appearing in the article "Survey of Ownership of Deposits — December 1958" (*Reserve Bank of India Bulletin*, July 1959) are almost wholly P.L. 480 deposits.

Chapter 4

THE NEW ISSUE MARKET: MANAGING AGENTS

(a) GENERAL: ISSUE AND UNDERWRITING OF CAPITAL

We are now in a position to study the constituents of the Indian capital market. There are two important aspects of a capital market, namely, the raising of new capital in the form of shares and debentures and trading in the securities already issued by companies. While the first aspect is obviously much more important from the point of view of economic growth, the second aspect is also of considerable importance. In fact, if facilities for transfer of existing securities are abundant, the raising of new capital is considerably assisted, for, the buyer of a new issue of security is confident that whenever he wants to get cash he can find a buyer without much difficulty. The constituents of capital market must therefore facilitate the fulfilment of the above twin functions. As already mentioned, like in any other market, intermediaries are required for bringing together the companies that issue capital (that is, the borrowers) and investors and again sellers and buyers of already issued capital. The efficiency of a capital market is judged by the extent of specialisation which, as is well known, depends to a large extent on the size of the market. It was mentioned at the beginning that the Indian capital market is by no means under-developed, though obviously the pattern of financial intermediaries is not so varied as in the very developed countries. In the Western countries, there is considerable specialisation to attend to the different stages in the formation of an enterprise and raising of capital, namely, promotion, issuing, underwriting and distribution of securities. Of course, it is not uncommon for the same agency to perform more than one of these functions. In India, specialised agencies do not exist in respect of promotion of companies, issue

and underwriting of shares. This is attributable, in the first instance, to the rather small volume of investment activity that characterised the Indian economy until recently. Conservative traditions of the commercial banking system, absence of private banking houses and poor development of institutions like investment trusts are other reasons. However, more than all these, the primary reason for the non-development of specialised agencies would appear to be the existence in India of a unique institution, namely, the managing agency system, which is a multi-purpose arrangement for promoting an enterprise, for raising capital and also for managing it.

It has already been mentioned that the demand for capital comes from various sources, viz., individuals, partnerships, joint stock companies, Government and semi-Government authorities and institutions. However, in the private sector, the joint stock companies constitute the most important category. A joint stock company can raise the funds it requires in various ways, namely, (i) issue of shares—ordinary and preference, (ii) sale of debentures, (iii) borrowings from banks and (iv) borrowings from other sources, including individuals. Borrowings from banks are usually for the purpose of meeting requirements of working capital. Issue of shares and debentures are primarily for meeting the requirements of fixed capital and also of a portion of working capital which is in the nature of long-term capital. The shareholders of a company are its *proprietors* whereas the holders of debentures are its *creditors*. Of course, a portion—even a major portion—of the debentures may be held by the shareholders themselves; in fact, sometimes a part or the whole of the debentures is offered to the shareholders, in the first instance. It has already been mentioned that in India equity capital constitutes a very large part of the total capital, preference shares and debentures being much less important. Equity capital, till recently, used to consist of ordinary and deferred shares, but the Companies Act of 1956 has banned deferred shares. The preference capital issued by Indian companies is mostly of the cumulative type, with the dividend being generally tax-free. In recent years, many of the issues are definitely redeemable, after and before a specified number of years. In a few cases, such as for instance, the Hindustan

Motors, the preference shareholders have a right of converting their holdings into ordinary shares, after a specified period and at pre-determined prices. Some preference shares are also entitled to participate in the profits, after a certain percentage has been distributed to the ordinary shareholders. In the case of some debenture issues too, the holders are entitled to convert the debenture stock into ordinary shares (e.g. Indian Aluminium Company issue).

In India, all the shares have a par value; that is to say, no par value shares are non-existent; shares are sometimes issued at a premium, occasionally a substantial one. The two most common denomination of ordinary shares in India are Rs. 100 and Rs. 10. The Rs. 10 shares are intended to attract the small investors. Preference shares have generally the denomination of Rs. 100, while in the case of debentures the denomination is higher, Rs. 500—1000, sometimes even higher, since these securities are mostly taken up by institutional investors.

The practice of joint stock companies' accepting deposits from the public is to be found all over the country, though it would appear that it is relatively concentrated in Bombay and Ahmedabad and also in Poona and the tea gardens of Bengal and Assam. These deposits are obtained both for working capital and for fixed capital. The depositors could be individuals, in many cases friends and relatives of the managing agents and/or directors. In Ahmedabad, it is reported, the depositors also get, sometimes, a share in the managing agency commission. No recent or precise data are available on the magnitude of such deposits; a figure of Rs. 15 - 20 crores was mentioned some years back. The rates of interest paid on these deposits are in many cases only slightly higher than the borrowing rates of banks, reflecting the confidence of the depositors in the borrowing company. The general impression is that the practice of accepting deposits from the public is not now so important as it used to be in the pre-war days, on account of the greater opportunities now available for raising capital; also, the textile industry, which is the most important industry to receive deposits, is very prosperous as compared to pre-war years generally. This is an area which offers scope for research (See Table 32 on page 119).

Turning back to the raising of money in the form of securities (i.e. shares and debentures), the ease or difficulty with which capital can be raised depends upon a number of factors, such as the size of the issue, whether the issue is by a new company or by an old company and if by the latter, its profits and dividend record, the people who are in charge of the company's management, the firm or institution that is in charge of underwriting, the terms of issue and finally the state of the stock market. Ordinarily, it is the relatively small and new companies which experience difficulties as compared to large and old companies. Issues of existing companies which have been doing well are naturally well received. Further, generally speaking, debenture issues and to a smaller extent preference shares are relatively easier to sell, since institutional investors have a preference for these securities, especially debentures; it is of course assumed that the rate of return on these securities is reasonably attractive. Also, ordinarily, periods of stock market boom are favourable for new issues, while a slump in stock prices is not conducive to success.

A brief reference may also be made to the methods of floating new issues in India*. There are broadly four ways in which securities can be issued, namely, (i) invitation to the public to subscribe, by the issue of a prospectus; (ii) offer for sale, whereby institutions or a group of individuals, including stockbrokers, who have taken up the whole or a large part of the issue of a company, offer the securities to the public at a fixed price; in this case too, particulars have to be provided to the public in the same way as in the case of the prospectus issue, referred to above; (iii) private placing, with institutional or other investors, followed by an application to the stock exchange for permission to list the security for transactions and (iv) offer to existing shareholders by a circular, which method can only be followed by established companies, wishing to issue additional capital. Of the above four methods, the first and the last are the most usual ones in India. Offer for sale is not usual in this country, except in the case of offer by a foreign company of a part of its capital to Indian

* A valuable and pioneering work on the subject of new issues is Shri M. A. Mulky's *The New Capital Issue Market in India* (1947).

investors. In any case, the requirements in respect of disclosure of information are the same as in the case of a prospectus issue. The third method is resorted to now and then, though it should be noted that at least 49 per cent of the issued capital has to be offered to the public for subscription in the first instance, under rule 19(2)(b) of the Securities Contracts (Regulation) Rules, 1957 (which came into force in February 1957), if a company is to be eligible for an official quotation on stock exchanges recognised by Government under the Securities Contracts (Regulation) Act, 1956. (It may be mentioned that the Bombay Stock Exchange has had a similar rule for many years). When there is participation by Government or foreign collaborators, their contribution is deducted from the total issued capital and public subscription has to be invited for at least 49 per cent of the balance. As a result of this requirement, the general practice has grown up for new companies to invite the public to subscribe for at least 49 per cent of their capital by the issue of a prospectus and the balance is placed privately amongst friends and associates or with institutional investors or with or through stockbrokers amongst their clients. This procedure works satisfactorily on the whole. Private placing enables companies to make certain of obtaining a not insignificant portion of the finances needed by them and on the other hand public offering safeguards the interests of investors who have an opportunity of participating in all important issues.

In the case of companies registered before 1957, whose shareholding is concentrated in a few hands, an official quotation is granted provided arrangements are made for the principal holders to release to the general public such number of shares as would raise the general public interest in the share capital of the company to about 40 per cent of the issued capital. The release has to be made by means of a public offer for sale duly advertised in the newspapers. Such offers for sale have often been made in recent times, notably, as mentioned earlier, by foreign entrepreneurs desiring closer participation of Indian interests. Sometimes, it happens that there is no public offer and the entire issue is subscribed for by the promoters or placed privately with their friends and associates. However, such companies are disqualified from

enjoying the privilege of an official quotation on any of the recognised stock exchanges. Naturally, this acts as a deterrent to such issues. It is in public interest and in the interests of the companies themselves to make a public issue, unless there are special circumstances to the contrary. In the case of debenture issues, which are privately placed with institutions like the LIC or a commercial bank, it may appear that listing on the stock exchanges is not necessary since the securities will be held till maturity. However, for purposes of valuation of securities, a stock exchange quotation will be necessary.

Where established companies desire to increase their capital, the general practice is to offer the new issue to the existing shareholders by means of a letter of offer specifying the time within which the 'right' shares may be applied for by the shareholders or by the nominees in whose favour the shareholders renounce their rights. At times, it is provided that the portion of the issue not taken up by the shareholders or their nominees would be offered for public subscription and in such cases a prospectus is simultaneously issued inviting the general public to apply for the shares.

The promoters of a company would naturally like to make it certain that the issue of capital is a success. Ordinarily there is not much difficulty in the case of debenture issues, since they are taken up by institutional investors. Generally, even before an issue is made public, the promoters will have done some canvassing among friends, relatives etc. for the purchase of shares and as already mentioned it is customary to mention at the time of issue that a specified number of shares will be allotted to the friends etc., the balance being available for public subscription. In respect of the shares offered to the public, a device is available to the promoters to ensure success of the issue, namely, *underwriting*. The underwriter (or underwriters), in return for a consideration, undertakes to purchase the shares etc. not taken by the public. Ordinarily the expectation is that the very fact that an issue is underwritten, particularly in cases where the underwriter is a reputed firm or institution, should help sell the securities to the public, so that the underwriters do not have to take up any or much of the issue. However, not

always is this so; underwriters may have to take up a rather large portion of the issue, especially if some adverse development occurs between the conclusion of the underwriting agreement and the actual issue of capital. That is why, in Western countries, underwriting is done through an *ad hoc* syndicate; the underwriter also makes arrangements for sub-underwriting, so that his risk is reduced very much, if not eliminated altogether.

As mentioned earlier, in India, unlike in the U.K. and the U.S.A., there have been no specialised agencies for underwriting. This is not to say that underwriting has been non-existent. Firms of stockbrokers, a few of the bigger scheduled banks, insurance companies, the two or three investment trusts proper and some individual financiers have all participated in underwriting. But the point to note is that this has been done on an *ad hoc* basis, as an incidental item of business. Statistics of underwriting operations are not readily available except for recent years. It would, however, seem that in the war and early post-war years, underwriting was subject to abuses. In some cases, underwriting was not done in the real sense of the term of accepting the liability for taking up the unsubscribed part of shares but it was merely a device to pay commission to some parties on the issue of capital. But things have changed much in this regard. Suitable provisions have also been made in the Companies Act to prevent malpractices in underwriting.

In this connection a brief reference may be made to the recommendation of the (Shroff) Committee on Finance for the Private Sector, which reported in April 1954. The Committee recommended the establishment of a consortium for underwriting purposes, comprising the leading commercial banks and insurance companies, under the leadership of the then Imperial Bank of India. To examine this suggestion further, the Reserve Bank appointed a committee under the Chairmanship of the Managing Director of the Imperial Bank. Surprisingly, the report of this Committee has not been published. However, my esteemed friend Shri H. T. Parekh, in his book *The Future of Joint Stock Enterprise in India*, has referred to press reports which indicated that the Committee took the view that commercial banks at best should go no further than underwrite de-

benture issues. In the meanwhile, both the Imperial Bank and the life insurance companies have been transferred into public ownership. Further, a new institution, viz. the Industrial Credit and Investment Corporation of India (ICICI) was set up in 1955, one of the important objects of this institution being the underwriting of securities. It would appear that the idea of setting up a formal consortium has been given up. But, underwriting itself has been growing, largely due to the impetus given by the ICICI. The Life Insurance Corporation (LIC) has begun to engage in underwriting operations. A number of leading scheduled banks have been participating in such activity on a fairly large scale. Finally, the Industrial Finance Corporation of India (IFC) has, after many years of unjustified inactivity, entered the underwriting field. The ICICI seems to have taken the initiative Sharebrokers, the LIC and even individuals have done underwriting. Thus, it would appear there will be a considerable amount of collaboration and co-ordination among the various institutions in the field of underwriting, which is more important than the establishment of a formal consortium.

The details of underwriting in respect of the important capital issues made in the four years 1956-59 and in January 1960 are given in Table 27. The amount underwritten during this period recorded a marked rise, from Rs. 1.7 crores in 1956 to Rs. 9.4 crores in 1959; underwriting as a *proportion* of total issues, also recorded a sharp rise, from something like under 5 per cent to, say, 20-25 per cent. In January 1960, four big issues were underwritten, the biggest being the Hindustan Aluminium issue of Rs. 8.35 crores, of which the entire public issue of Rs. 4.66 crores was underwritten by several institutions. This appears to be the biggest public issue of *share* capital so far made by a new company. It will be seen that the ICICI and some leading scheduled banks figure prominently in the underwriting operations. to seek the collaboration of the IFC and the LIC for underwriting. In Chapter 3, it has been mentioned that in the 2 years and 4 months ended December 1958, the LIC underwrote 40 issues for Rs. 4.61 crores, most of which were debenture and preference capital. Many issues have more than one underwriter. Not in all

TABLE 27

UNDERWRITING OF SECURITIES

1956

(Rs. lakhs)

Company	Amount issued	Amount to be taken up by: Promoters, Managing Agents, Directors, and Friends	Amount to be taken up by: Foreign Collaborators	Amount offered to the Public/Shareholders	Underwriting: Type of Security	Underwriting: Amount underwritten	Underwriting: Underwriters	Underwriting: Underwriting commission (percent)
1	2	3	4	5	6	7	8	9
Polychem	40(O)	20(O)*	—	20(O)	O	20	ICICI	
	40(P)		—	40(P)	P	20	—do—	2
						20	Bank of Baroda	
Cauvery Sugars and Chemicals	29(O)	—	—	29(O)	O	20	ICICI	
	20(P)	—	—	20(P)		5	Hercules Insurance Co.	2
						2	Deccan Sugar and Abkhari Co.	
						2	Parry & Co. East India Distilleries & Sugar Factories	Nil
					P	10	ICICI	
						5	Hercules Insurance Co.	2
						5	M/s. N. R. Sundararaja Iyer	Nil

TABLE 27 (Contd.)

1956 (Contd.)

(Rs. lakhs)

1	2	3	4	5	6	7	8	9
Saurashtra Cement & Chemicals	100(O)	50(O)	—	50(O)†	O	30)	Central Bank of India	2
	50(P)	25(P)	—	25(P)†	P	15)		
New India Fisheries	11(O)	2(O)	5(O)	4(O)	O	6)	Union Bank of India	2
	4(P)	1(P)	2(P)	1(P)	P	2)		
Ferro-Alloys Corporation	40(O)	23(O)	—	17(O)	O	7	ICICI	2
	20(P)	11(P)	—	9(P)				
South India Tea & Coffee Estates	2(D)	—	—	2(D)	D	2	P. R. Subramanyam	3
Total	356	132	7	217		171		

* Including the amount to be taken up by Dow Chemical Co. of Midland, U.S.A.

† Of this, promoters had guaranteed subscription by directors, their friends etc. of Rs. 20 lakhs ordinary and Rs. 10 lakhs preference, if not taken up by public.

O = Ordinary.

P = Preference.

D = Debentures

TABLE 27 (Contd.)

1957

(Rs. Lakhs)

1	2	3	4	5	6	7	8	9
Adoni Spinning & Weaving	15(O)	6(O)*	—	9(O)	O	9)	Investment Corpn.)	
	10(P)	2(P)*	—	8(P)	P	3)	of India)	2
					P	5	LIC)	
Amar Dye Chem.	30(O)	15(O)	—	15(O)	O	15	ICICI	2½
Shree Bhawani	13(P)	—	—	13(P)	P	10	ICICI)	
Cotton Mills						3	Loyalka & Sons)	2
Dunlop Rubber	140(O)	—	—	140(O)†	O	140	Place Siddons & Gough	
Kalyanpur Lime & Cement Works	22(O)	11(O)	—	11(O)	O	11	ICICI	2½
Ashok Leyland	102(O)	—	52(O)	50(O)	O	50	—do—	2½
Jeypore Sugar	10(P)	—	—	10(P)	P	5	LIC)	
						3	P. R. Subramanyam)	
						2	Somayajulu & Co.)	
Total	342	34	52	256		256		

* To be taken up by three Insurance Companies.

† Include amount to be taken up by Dunlop Rubber Co. England.

TABLE 27 (Contd.)

1958

(Rs. Lakhs)

1	2	3	4	5	6	7	8	9
Mahindra & Mahindra	77(O)	—	—	77(O)	P	10	LIC)	2
	30(P)	—	—	30(P)		10	ICICI)	
Anil Hardboards	30(O)	12(O)	3(O)	15(O)	O	12)	ICICI	2½
	10(P)	—	—	10(P)	P	10)		
Indian Oxygen	60(O)	—	—	60(O)	O	60	—do—	2
CEAT Tyres of India	115(O)	—	69(O)	46(O)*	O	46	Investment Corpn. of India	2
Southern Structurals	50(O)	20(O)	—	30(O)	O	10	Chitra & Co.	2½
Ganga Sugar Corporation	13(P)	—	—	13(P)	P	13	Union Bank of India	2
Premier Automobiles	160(D)	—	—	160(D)	D	35	LIC)	
						75	IFC)	2
						50	ICICI)	
Dunlop Rubber Co.	100(D)	—	—	100(D)	D	100)	LIC)	
						)	Investment Corpn. of India)	2
						)	ICICI)	
Guest, Keen, Williams	150(D)	—	—	150(D)	D	(40	LIC)	
						(70	Place Siddons & Gough)	
						(20	Lewis & Jones)	2
						(20	Batliwala & Karani)	
Minerva Mills	18(D)	—	—	18(D)	D	18	Canara Bank	2½
Century Spg. & Mfg. Co.	125(P)	—	—	125(P)	P	125	Central Bank of India	1½
Shree Nivas Cotton Mills	30(D)	—	—	30(D)	D	30	Union Bank of India	1½
TOTAL	968	32	72	864		754		

* Of this, Rs. 6 lakhs were to be subscribed by Investment Corporation of India and/or its directors, associates and friends.

TABLE 27 (Contd.)

1959

(Rs. lakhs)

1	2	3	4	5	6	7	8	9
Mysore Kirloskar	15(O)	—	—	15(O)	O	15	R. R. Nabar & Co.	1
Hind Cycles	30(P)	—	—	30(P)	P	20	United Bank of India	1
Khandelwal Ferro Alloys	100(O)	65(O)	—	35(O)	P	38	IFC	)
	50(P)	—	—	50(P)		8	P. R. Subramanyam	)
						5	S. V. Bhavnani	) 2½
Cooper Engineering	20(O)	—	—	20(O)	O	20	ICICI	2
West Coast Paper	50(O)	—	—	50(O)	P	30	ICICI	2
	30(P)	—	—	30(P)				
Simplex Mills	60(D)	—	—	60(D)	D	60	Investment Corpn. of India	)
								) 2
							United Comml. Bank	)
Cellulose Products of India	20(O)	10(O)	—	10(O)	P	10	Bank of Baroda	1½
	15(P)	5(P)	—	10(P)				
Textile Machinery Corpn.	100(P)	—	—	100(P)	P	100	Central Bank	2
Mandya National Paper*	140(O)	38(O)	62(O)	40(O)	P	30	ICICI	)
	60(P)	—	—	60(P)		15	LIC	) 2½
						15	Union Bank	)
Straw Products	125(O)	—	—	125(O)	O	25†	ICICI	1½
	75(P)	—	—	75(P)	P	25	ICICI	) 2½
					P	50	IFC	)
Baroda Rayon Corporation	350(O)	164(O)	27(O)	159(O)	O	159	Gaekwar Investment	1

TABLE 27 (Contd.)

1959

(Rs. lakhs)

1	2	3	4	5	6	7	8	9
K.C.P.	43(P)	20(P)‡	—	23(P)	P	8	P. R. Subramanyam	2½
						8	Somayajulu & Co.	
						5	Andhra Bank	
Indian Aluminium	300(D)	—	—	300(D)	D	275	Place Siddons & Gough	2
						25	LIC	
Total	1583	302	89	1192		946		

* The Government of Mysore had agreed to take up any unsubscribed part of the ordinary issue of about Rs. 40 lakhs.

† Rs. 1 crore of ordinary shares which have not been underwritten, or so many thereof as are not subscribed were guaranteed to be subscribed by the Managing Agents and three Directors.

‡ To be subscribed by the Central Bank and LIC.

TABLE 27 (Contd.)

1960 (January only)

(Rs. lakhs)

1	2	3	4	5	6	7	8	9
Premier Tyres	150(O) 50(P)	46(O) 50(O)* 15(P)	10(O)	44(O) 35(P)	P	10†	LIC	2
Associated Battery Makers (Eastern)	68(O)	—	20(O)	48(O)	O	48	Place, Siddons & Gough	2½
Hindustan Aluminium Corporation	585(O) 250(P)	213(O)	156(O)	216(O) 250(P)	O P	25 75	ICICI	
					O P	15 35	Central Bank of India	1 (O)
					O P	10 35†	LIC	2½(P)
					P	25	Bank of India	
					P	25	Bank of Baroda	
					O P	20 45	United Commercial Bank	
					O P	10 10	Union Bank of India	
					O	76	Hindustan Investment Corporation	
					O	60	Produce & Share Brokers	
Asian Cables Corpn.	50(O)	25(O)	§	25(O)	O	12.50	United Commercial Bank	1½
					O	12.50	Devkaran Nanjee Banking Company	

* Amount subscribed by the Government of Kerala.

† These shares are agreed to be taken up by the LIC itself.

§ The ICICI has agreed in principle to lend the company an amount in foreign currencies equivalent to Rs. 21.5 lakhs.

cases is the whole amount of issue underwritten; a part, sometimes a good part, of the issue is taken up by the promoters, their associates, friends and relatives. There have also been big issues of well known and long established companies which have not been underwritten at all; for example, the ordinary and preference share issues of the Tata Steel Company and the ordinary share issues of the Indian Iron and Steel Company. On the other hand, some good issues which did not require underwriting at all, have been underwritten. Perhaps, to some extent, underwriting is tending to become a fashion.

The arrangements for the distribution of the securities are fairly satisfactory, with a large number of stockbrokers. It is customary to appoint one or more 'managing' brokers to every issue, so that they make sufficient canvassing to sell the securities. For example, for the Hindustan Aluminium issues there were as many as 7 managing brokers. Managing brokers usually receive an extra brokerage over and above what ordinary brokers receive, which is usually 1 per cent of the nominal value. There are seven stock exchanges. Some stockbrokers also engage in underwriting and sub-underwriting.

In India, unlike in Germany and Japan, the role of commercial banks in industrial finance is relatively a minor one. Their chief activities in the capital market relate to transactions in Government securities on a large scale and to a much smaller extent in debentures. The Indian commercial banks, like British banks, have confined their activities mostly to the provision of short-term finance. However, in recent years, because of the accelerated tempo of investment activity in the economy, there appears to have been some increase in term lending (in substance though not necessarily in form) by banks to industry for purchase of capital equipment. It is significant that official attitude (i.e. that of Government and the Reserve Bank) is now in favour of some term lending by banks. There is a feeling that it would be appropriate in the circumstances of rapid planned development, for banks to engage themselves, on a modest scale, in the provision of medium-term finance for industry. The establishment of the Refinance Corpoation for Industry in June 1958, jointly owned by the Reserve Bank, the State Bank, 14 other leading commercial

banks and the LIC, with a loan of Rs. 26 crores from Government, out of the counterpart funds of P. L. 480 imports from the U.S.A., will facilitate term lending by banks as they can get rediscounting facilities from the Refinance Corporation (see Chapter 6). However, by and large, the approach is that long-term financing should be done not by banks but by special institutions in which, of course, banks might participate as shareholders; this attitude appears to be quite justified. Recently, however, banks have been engaging in underwriting activity on a growing scale.

In India, there is a certain amount of direct financial assistance from the Government to selected industries or industrial units. Most of the State Governments have State Aid to Industries Acts though, by and large, their contribution is very small. It would appear that the financial assistance to the small-scale industries in particular would be stepped up in the years to come.

It would also appear that in the coming years capital provided by foreign collaborators and the loans of the Export-Import Bank of Washington would expand significantly. The Hindustan Aluminium Company, referred to above, is stated to have been sanctioned a dollar loan, equivalent to Rs. 6.5 crores, by the Ex-Imp. Bank; a rupee loan of Rs. one crore is expected from the same source, out of P. L. 480 counterpart funds.

(b) MANAGING AGENCY SYSTEM

We may now turn to the study of that unique institution in India, namely, the managing agency system, which, as already mentioned, is a multi-purpose arrangement, not only for promoting industries but also for raising capital (fixed as well as working) and for managing them. This system has been subject to much criticism and in consequence statutory provisions have been made, first in the Companies Act Amendment of 1936 and again in the new comprehensive Act of 1956, to which a reference has already been made in Chapter 2, for the regulation of the activities of managing agents. The future of the system is quite uncetain. In fact, in the study *The Future of Joint Stock Enterprise in India,* referred to earlier, Shri H. T. Parekh has argued the case cogently for the abolition of the system. Whatever may be the

criticisms, the fact remains that the managing agency system has contributed to no small extent to industrial growth. In the post-Independence period in particular the growth of industry has been phenomenal. Although a lot of inspiration for this has come from the ambitious plans of Government, it is clear that private enterprise, and especially the managing agency system, has done much to raise the tempo of growth significantly. The point to remember is that the system could not have continued for a long time unless it had grown organically and possessed a certain inherent strength and usefulness. However, it is not necessary to anticipate a further discussion about the efficacy of the system. It is good to begin by a description of the system. Fortunately, in recent years, a lot of statistical material about the working of the managing agency system has become available, the most comprehensive being an official publication entitled *Managing Agencies in India—First Round: Basic Facts* by Dr. Raj K. Nigam, of the Research and Statistics Division of the Department of Company Law Administration. Some useful data are also available in a recent book *The Managing Agency System—In Prospect and Retrospect,* by an eminent authority on industrial finance, Professor S.K. Basu of the Calcutta University. The latest publication on the subject, which became available as this chapter was being completed, is a study entitled *The Managing Agency System,* by the National Council of Applied Economic Research (NCAER), New Delhi. Dr. Basu's as well as the NCAER's study have made extensive use of Dr. Nigam's statistics. The data given in Dr. Nigam's publication relate mostly to the year 1954-55. Since then some changes would, no doubt, have occurred and it is extremely difficult to say to what extent the changes would affect the conclusions that emerge from the study of data as of 1954-55.

During 1954-55, there were 3,944 managing agencies which managed 5,055 joint stock companies out of a total of 29,625 joint stock companies at work in that year. That is to say, only 17 per cent of the total number of companies were managed by managing agents but these companies accounted for nearly half of the total paid-up capital of all companies. As may be expected, the managing agency system is much more prevalent in the public limited companies than in private limited companies; thus,

40.7 per cent of public limited companies accounting for 66.3 per cent of total paid-up capital had managing agents; the corresponding percentages for the private limited companies were 4.9 and 8.6 (Table 28). Managing agents are organised variously, namely, unincorporated firms, private limited companies and public limited companies; their distribution and the public and private limited companies managed by them are set out in Table 29. It will be seen that about two-thirds of the managing agencies are unincorporated firms and a substantial part of the remaining consisted of private limited companies. Managing agency firms which are organised as public limited companies numbered 184, the growth of this form being largely a phenomenon of World War II and the post-war period. The total paid-up capital of the company type of managing agencies amounted to Rs. 76 crores. Out of the total capital of Rs. 465 crores of the managed companies, as much as Rs. 370 crores are accounted for by companies under managing agencies which are organised in corporate form.

It is also interesting that a vast majority of the managing agency houses, namely, 3,526, managed just a single company each (Table 30). The number of managing agency houses which managed from 2 to 9 companies was 401. Only 17 managing agencies managed 10 or more companies. The total paid-up capital of these 17 agencies amounted to Rs. 18.5 crores and the total paid-up capital of the companies which they managed to Rs. 114 crores.

In this book we are primarily interested in the role of managing agents as financial intermediaries, that is to say, the extent to which the managing agents assist in obtaining long-term capital in all ways—equity, preference, debenture and long-term loans and deposits. The managing agents, in fact, also play some part in procuring short-term finance from banks. We must also make a distinction between the direct financing by managing agents out of their own resources and the indirect financing they do through their friends and associates and also the finance they attract because of the association of their names with the companies. Adequate data are not available on the subject. However, such data as are available (the bulk of which are given in Prof.

TABLE 28

COVERAGE OF JOINT STOCK COMPANIES BY MANAGING AGENCIES

(*Amount in crores of rupees*)

	Public		Private		Total	
	No.	Paid-up Capital	No.	Paid-up Capital	No.	Paid-up Capital
1. Companies managed by Managing Agencies	4091	4,39.0	964	26.4	5055	4,65.4
2. Total Companies at work during 1954-55	10056	6,62.5	19569	3,08.3	29625	9,70.8
3. Total companies excluding Banking & Insurance companies at work during 1954-55	9178	6,16.6	19464	3,07.3	28642	9,23.9
4. 1 as percentage of 2	40.7	66.3	4.9	8.6	17.1	47.9
5. 1 as percentage of 3	44.6	71.2	4.9	8.6	17.7	50.4

TABLE 29

OVERALL POSITION OF THE MANAGING AGENTS

(*Amount in crores of rupees*)

Class of Managing Agencies	Managing Agencies		Private managed companies		Public managed companies		Total Private & public managed companies	
	No.	Paid-up capital	No.	Paid-up capital	No.	Paid-up capital	No.	Paid-up capital
Unincorporated Mg. Agency firms ...	2,522	...	588	8.1	2,183	87.1	2,771	95.2
Private Mg. Agency Companies ...	1,238	32.0	316	11.6	1,464	243.4	1,780	255.0
Public Mg. Agency Companies ...	184	44.1	60	6.8	444	108.5	504	115.2
Total ...	3,944	76.1	964	26.4	4,091	439.0	5,055	465.4

TABLE 30

FREQUENCY DISTRIBUTION OF MANAGING AGENCIES

No. of companies managed	Unincorporated managing agency firms	Private managing agency companies	Public managing agency companies	Total
1	2	3	4	5
1	2350	1039	137	3526
2	127	107	16	250
3	29	31	4	64
4	10	23	4	37
5	2	9	3	14
6	1	7	4	12
7	1	3	5	9
8	1	8	1	10
9	1	4	—	5
10	—	1	—	1
11	—	—	1	1
12	—	1	—	1
13	—	—	1	1
14	—	2	1	3
20	—	—	1	1
21	—	1	—	1
22	—	—	1	1
23	—	1	2	3
28	—	—	1	1
32	—	—	1	1
39	—	—	1	1
40	—	1	—	1
Total	2522	1238	184	3944

Source: *Managing Agencies in India-First Round*: *Basic Facts*, *by* Raj K. Nigam.

Source: *Managing Agencies in India-First Round*: *Basic Facts*, by Raj K. Nigam.

Basu's and the NCAER's studies) may be indicated here. The extent of direct financial assistance, especially in the form of share capital, by the managing agents would appear to vary from region to region, and also depend on the size of the managed company. In western India, i.e. Bombay and Ahmedabad, the

managing agents would appear to hold a larger percentage, in some cases absolute majority, of shares than in Calcutta where the managing agency system is more widely prevalent. Also, in recent years the general tendency, especially in the Calcutta area, seems to be for an increase in shareholding by the managing agents for fear of take-over of the managing agency by rival groups. A rough measure of the direct financial contribution of the managing agents to the finances of the managed companies is given by the ratio of the total paid-up capital of the managing agency houses to the capital of the managed companies. These data are, of course, available in respect of the managing agencies which are run on corporate lines. While the total paid-up capital of the managed companies amounted to Rs. 370 crores, the 1,422 managing agency companies had a total paid-up capital of Rs. 76 crores, or roughly 20 per cent of the former. In the case of the 17 top managing agency houses which between themselves managed 359 companies, the ratio was 16 per cent; the percentage in respect of individual managing agency houses varies from a low of 2.4 to 105.4. Prof. Basu has also referred to data compiled in the Research and Statistics Division of the Company Law Administration in respect of 1,340 managing agencies managing 1,720 companies. It is seen that out of a total paid-up capital of Rs. 215 crores of the companies, the share capital subscribed by the managing agents amounted to Rs. 29 crores or 13.58 per cent (Table 31). Further, Prof. Basu has made an analysis of 180 companies (14 private limited and 166 public limited) managed by 25 managing agencies (6 Indian and 19 European) which are incorporated in Calcutta. His finding is that the average share holding of the managing agencies in the private companies is 19.01 per cent while in the case of public companies it is 16.99 per cent. The average holding of the European managing agency houses is 10.11 per cent while that of the Indian managing agencies is as high as 42.36 per cent. (However, the NCAER's analysis of 125 companies run by British managing agency houses reveals that the average holding of shares by the managing agents was larger, namely, 17 per cent). The average holding also varies widely from industry to industry, the smallest being 5.03 per cent in respect of coal companies.

TABLE 31

FINANCIAL PARTICULARS RELATING TO 1340 MANAGING AGENTS IN 16 STATES IN INDIA MANAGING 1720 COMPANIES (1951-52)

(Amounts in lakhs of rupees)

State	No. of managed Companies taken into account	Paid-up capital	Share capital subscribed by Managing Agent	Percentage of capital subscribed by Managing Agent	Loans and advances made by Managing Agent	Loans guaranteed by Managing Agent	Loans from banks	Total loans and advances	Loans and advances made or guaranteed by Managing Agent as % of total loans and advances
1. Andhra	53	1,62	25	15.43	32	2	1	35	97.14
2. Assam	15	12	1	8.33	1	5	2	8	75.00
3. Bihar	81	5,48	28	5.11	3	57	55	1,15	52.17
4. Bombay	589	1,22,91	21,79	17.73	3,76	1,14	34,04	38,94	12.58
5. Madhya Pradesh	45	1,03	19	18.45	7	5	15	27	44.44
6. Madras	331	26,62	1,26	4.73	61	1,07	5,61	7,29	23.05
7. Punjab	53	2,69	52	19.33	4	—	1,08	1,12	3.57
8. West Bengal	264	13,78	96	6.97	96	20	5,48	6,64	17.47
9. Hyderabad	41	9,18	1,61	17.54	2,62	3,34	4,00	9,96	59.84
10. Madhya Bharat	51	12,91	59	4.57	1,12	—	3,42	4,54	24.67
11. Mysore	41	2,54	23	9.06	36	53	81	1,70	52.35
12. Pepsu	17	2,09	18	8.61	—	—	42	42	—
13. Travancore-Cochin	50	7,80	28	3.59	28	21	31	80	61.25
14. Delhi	75	6,22	1,04	16.72	35	58	2,24	3,17	29.34
15. Ajmer	9	20	7	35.00	1	—	—	1	100.00
16. Tripura	5	2	1	50.00	—	—	—	—	—
Total	1720	2,15,21	29,22	13.58	10,54	7,76	58,14	76,44	23.94

Source: *The Managing Agency System In Prospect and Retrospect*, by Prof. S. K. Basu.

In the NCAER's study, the contribution of managing agents to equity capital is examined in respect of 66 companies in the Bombay area, as of March 1958. It is found that in respect of 61 companies, with subscribed capital varying upto Rs. 100 lakhs, the percentage of capital subscribed by the managing agents varies from 24 to 35 per cent, in respect of each range of subscribed capital. In the case of the 5 companies with capital of over Rs. 1 crore, the managing agents' share was very small, namely 3.8 per cent. It is also stated that the actual holding of the managing agents is larger, since some shares are held *benami* (in the names of others). It is, of course, difficult to generalise from the data relating to 66 companies.

The managing agents are also of considerable assistance in the matter of providing loans, both out of their own resources as well as by guaranteeing the loans which the managed companies obtain from banks. Comprehensive data on this aspect of the managing agents' role are not available. According to the data relating to 1340 managing agencies for the year 1951-52, referred to earlier, the loans and advances made by the managing agents amounted to Rs. 10.54 crores and loans guaranteed by the managing agents amounted to Rs. 7.76 crores. The other loans which the companies obtained from banks amounted to Rs. 58.14 crores, which means that loans and advances made or guaranteed by the managing agents constituted almost 25 per cent of total loans and advances obtained by the managed companies. The NCAER study also gives some data on the loans (including purchase of debentures) provided by the managing agents, as of the year 1955. For this purpose two samples have been taken, one of 84 companies each with a paid-up capital of Rs. 75 lakhs or more and another of 143 'middle-sized' companies, having a paid-up capital in the range of Rs. 10-25 lakhs (Table 32). It is seen that in the case of the large-sized companies the direct loans of managing agents as a proportion of all loans is insignificant, namely, 1.3 per cent; in the case of the 'middle-sized' companies, however, the percentage is larger, namely, 7. (In the case of 143 companies managed by British managing agency houses, the corresponding percentage is 6.52). Incidentally, it will be noticed that in the case of the middle-sized units, bank

TABLE 32

LOANS TO COMPANIES MANAGED BY MANAGING AGENTS

(Amounts in crores of Rs.)

Description of source or item		Large-sized (84 cos.) Total amount	Large-sized (84 cos.) Percentage of total loans & advances	Middle-sized (143 cos.) Total amount	Middle-sized (143 cos.) Percentage of total loans & advances
1. Debentures	...	29.74	25.4	2.37	8.2
2. Fixed deposits	...	2.90	2.4	2.69	9.2
3. Secured loans from banks	...	38.40	32.2	14.94	51.6
4. Unsecured loans from banks	...	4.35	3.4	2.55	8.8
5. Loans from World Bank*	...	5.84	5.1	—	—
6. Loans from Central and State Governments and statutory financial corporations	...	30.69	26.3	1.86	6.4
7. Direct loans from managing agents**	...	1.54	1.3	2.02	7.0
8. Other loans and advances, including those from subsidiary companies	...	4.59	3.9	2.55	8.8
Total	...	118.05	100.0	28.97	100.0

* To companies managed by Tatas' agencies and to the Indian Iron and Steel Co.

** Including the debentures and fixed deposits held by them.

Source: '*The Managing Agency System*' by the National Council of Applied Economic Research.

loans as well as fixed deposits are more important than in the case of the large-sized units. A substantial portion of loans taken by the companies from banks is guaranteed by the managing agents, though surprisingly the guarantee is larger (i) in the case of large companies than in the case of smaller companies and (ii) in the case of secured advances as compared to unsecured advances. Thus, in the case of the 84 large-sized companies, the amount of bank loans guaranteed by the managing agents constituted 70.8 per cent of the secured loans and 31.5 per cent of unsecured loans; the corresponding percentages in the case of the middle-sized companies were 52.1 and 28.4.

It should, however, be emphasised that to some extent the guaranteeing of bank loans by the managing agents is a kind of a routine practice that has developed over the years. In other words, while the standing, both financial as well as entrepreneurial, of the managing agent is of some importance in regard to bank credit, what is of more fundamental importance is the financial position of the managed company itself. At the time the new Companies Act was being passed, there was widespread fear that the measure might adversely affect the provision of bank finance for industry, as it was thought that managing agents might either be unwilling or unable to stand the guarantee and that banks would pursue a restrictive policy in the absence of guarantees. These fears have turned out to be unfounded. The flow of bank credit has been going on in the usual way. In fact, it is not unlikely that because of the stringent regulatory provisions concerning the managing agents it is safer to provide finance to the managed companies, on account of the diminished scope for misdirection of funds.

In respect of providing capital, while the direct contribution of managing agents is undoubtedly significant, it would appear that their indirect contribution is even more significant. In the first place, the managing agents attract capital from a large circle of friends, relatives and associates. The amount of canvassing they do in this regard is substantial, comparable to the work done by professional underwriters. Secondly, the managing agents, not infrequently, use the funds of other companies in

their control for subscribing to the capital of a company that is in need of funds. Such investment may be purely temporary, the shares being sold by other companies as soon as circumstances become favourable. There is, of course, the danger that such inter-company investments may tend to become unhealthy and there are some instances where such investment has definitely been harmful to other companies. By and large, it would appear that such inter-company investment has been beneficial and has indeed been one of the strong points of the managing agency system. Of course, during the war years and the immediate post-war years, the activities of some managing agents were such as to divert resources from the managed companies for speculative activities intended to benefit the managing agents only. That was, however, an abnormal period, the phenomenon of irresponsible speculation being quite widespread in the economy in the context of a serious inflation. The new Companies Act has done much to restrain such activities of the managing agents and the amendment bill, which is now before Parliament, will further plug the loopholes.

There is another aspect of the managing agency system which affects the finances of companies and that is the remuneration paid to managing companies. As already mentioned in Chapter 2, the 1956 Companies Act contains provisions for restricting the remuneration to the managing agents which in the past was regarded as being excessive, in many cases. Studies on company finances prepared by the Reserve Bank contain data on remuneration to managing agents, which may be summarised here. At the outset it may be mentioned that the managing agent's remuneration is usually expressed as a certain percentage of what is defined as 'net profits' for the purpose in the Companies Act, namely, profits after depreciation but before taxation plus the managing agency remuneration. The ceiling of 10 per cent mentioned in the Companies Act 1956 refers to the above defined item. It is observed that since 1955 there has been a decline in the remuneration, which is mainly due to the provisions of the 1956 Act. During the 6-year period 1950-55, remuneration to managing agents of about 750 non-financial companies included in the Reserve Bank study constituted 13.3

TABLE 33

MANAGING AGENCY REMUNERATION

(Rs. crores)

	750 companies							1001 companies	
	1950	1951	1952	1953	1954	1955	Total 6 years	1956	1957
1. Managing Agency Remuneration	10.00	12.64	10.57	10.44	11.29	13.53	68.47	11.83	8.39
2. Profits before Tax* ...	63.68	85.16	55.70	65.63	78.46	97.36	445.99	128.76	104.45
3. (1 + 2) ...	73.68	97.80	66.27	76.07	89.75	110.89	514.46	140.59	112.84
4. Profits after Tax ...	38.54	51.55	31.03	38.60	45.80	59.55	265.07	69.96	53.19
5. Distributed Profits ...	23.74	26.99	24.46	26.07	29.22	32.22	162.70	42.31	41.98
6. Retained Profits ...	14.80	24.56	6.57	12.53	16.58	27.33	102.37	27.65	11.21
7. (1) as percentage of (3) ...	13.6	12.9	15.9	13.7	12.6	12.2	13.3	8.4	7.4

* The data also relate to companies not having managing agents.

Source: Reserve Bank of India Bulletins, September 1957 and August 1959.

per cent of net profits as defined above. The corresponding figure for the 5-year period 1946-51 for companies covered in the study of the Taxation Enquiry Commission had been almost the same, namely, 14.0 per cent. In the two years 1956-57, however, it fell to 8 per cent (Table 33). The shortcoming of the above figures is that not all the companies covered in the study had managing agents. We should study only those companies which had managing agents. These data are available for the four years 1950-53 and the three years 1955-57. It is observed that in the three years 1950-52, managing agency remuneration accounted for 16,4 per cent of net profits. It was 15.5 per cent in 1953, 14.2 per cent in 1955, 11.5 per cent in 1956 and 11.7 per cent in 1957. If the companies which made losses are excluded, the percentage would be lower. But these data are not readily available. Since in 1957 quite a few companies, especially in the cotton textile industry, made losses, the actual percentage of managing agency remuneration in respect of companies making profits would be significantly smaller.

Chapter 5

ROLE OF COMMERCIAL BANKS IN THE CAPITAL MARKET

General

Commercial banks are an important constituent of the capital market but their operations in the capital market are mostly confined to the purchase and sale of Government and other trustee securities. Their holdings of industrial securities, i.e. debentures and shares, are very small. Thus, scheduled banks, as at the end of the year 1958, held Government securities of the value of Rs. 664 crores, constituting a little over 40 per cent of their liabilities (Table 34). On the other hand, their holdings of shares of joint stock companies amounted to a little over Rs. 9 crores and of debentures to a little over Rs. 6 crores, or a total of just Rs. 15 crores. The holdings of shares and debentures have shown comparatively little change over the years. Over the last 10 years or so, the aggregate of the commercial banks' holdings of shares and debentures has recorded a rise of hardly Rs. 3 crores as compared to a rise of about Rs. 300 crores in Government securities; it should, however, be noted that the net increase in the latter was largely accounted for by a special factor, namely, investment of P. L. 480 counterpart funds deposited with the State Bank of India. It must not be gathered that bank holdings of Government securities have recorded a continuous rise; there have, in fact, been fluctuations on either side, depending upon the expansion of credit.

The role of the Indian banking system in the provision of long-term finance is extremely limited. In this respect the Indian banking system is very much similar to the British system and in contrast with that in the United States, Japan and Germany. It has already been stated that investments of banks in shares and debentures of companies is extremely small. Even as regards the advances of banks, they are almost wholly for short-term, to meet

TABLE 34

INVESTMENTS IN INDIA OF SCHEDULED BANKS, 1949, 1954 AND 1958

(Rs. crores)

		December 31, 1949	December 31, 1954	December 31, 1958
A. Indian Government securities* :				
1. Central Government	...	328.05	322.40	566.16
2. State Governments	...	29.23	34.95	97.18
3. Others, mainly postal†	...	0.04	0.18	0.21
Total of A	...	357.32	357.53	663.55
B. Other Investments :				
1. Other trustee securities	...	5.10	10.77	30.90
2. Fixed deposits	...	0.45	3.52	5.21
3. Shares of joint stock companies	...	13.28	6.87	9.29
4. Debentures of joint stock companies	...		4.40	6.15
5. Real estate	...	4.78	6.54	8.41
6. Bullion	...	0.59	0.02	0.07
7. Others	...	0.60	0.35	0.54
Total of B	...	24.80	32.46	60.57
TOTAL OF A AND B	...	382.12	389.99	724.12

* Face Value.

† Includes Treasury Savings Deposit Certificates and Postal obligations.

Source: Reserve Bank of India: *Reports on Trend and Progress of Banking in India.*

the requirements of borrowers for working capital. It is true that many of the advances are rolled over from one short period to another, thus remaining outstanding with the borrowers for a fairly long period, but the banks have always the right to get repayment at the end of the specified short-term period. It is generally believed that in recent years during which the Indian economy has been witnessing a marked expansion in the public as well as private sectors, banks have, in fact, been providing on an increasing scale at least medium-term finance for the purchase of capital equipment. The finance is often for a few years pending the raising of capital by the borrowing company through the issue of shares or debentures. Such advances may be given either against the mortgage debentures specially created for purposes of security or as regular loans against raw materials and/or finished goods or a charge on the amounts which are not intended to be recalled for sometime. Statistics of term lending by Indian banks are not available but on the whole such lending is perhaps still marginal in character.

The above remarks apply to the direct provision of medium or long-term finance for industry. The banks are in fact contributing, in a steadily rising measure, finance for meeting the requirements of working capital for industry. It is generally agreed that a part of the requirements of a company for working capital is really in the nature of fixed capital insofar as there is an irreducible minimum of investment on inventories. Normally this part of capital is also expected to be raised through the issue of shares and debentures. Insofar as this requirement is met by borrowing from banks it could be said that the banks are providing some long-term finance. Even in regard to working funds, the reliance of industry on bank finance has been on the increase in recent years; the proportion of borrowings from banks to total working capital of the corporate industrial sector has increased from about 6 per cent in 1954 to 20 per cent in 1957; these figures under-estimate the role of banks in the provision of industrial finance as they do not take into account extension of credit in the form of bills. The statistics of advances by the Indian banking system reveals a more or less steady rise in the ratio of advances made to industry to the overall level of bank advances. Thus,

while in June 1954, which marks roughly the beginning of the investment boom in India, advances by scheduled banks to industry constituted 34 per cent of all advances, in April 1959 advances to industry constituted as much as 46 per cent of total advances. During this 5-year period, scheduled banks' advances to industry recorded a rise of 144 per cent as compared to a rise of about 81 per cent in overall advances (Table 35).

TABLE 35

SCHEDULED BANK ADVANCES BY PURPOSE

(Rs. crores)

Date: Last Friday	Total	Industry	Commerce	Personal & Professional	Others
June 1951	584	209	294	40	42
		(35.7)	(50.4)	(6.8)	(7.1)
June 1954	564	193	275	45	52
		(34.2)	(48.7)	(8.0)	(9.1)
June 1955	626	241	292	55	37
		(38.6)	(46.7)	(8.8)	(6.0)
June 1956	764	300	356	58	49
		(39.3)	(46.6)	(7.6)	(6.4)
June 1957	925	390	414	61	59
		(42.2)	(44.8)	(6.6)	(6.4)
April 1958	975	442	413	64	56
		(45.3)	(42.4)	(6.5)	(5.7)
April 1959	1020	471	414	71	63
		(46.2)	(40.6)	(7.0)	(6.2)

Note: Figures in brackets are percentages of the group to the total.

While the investments of banks in industrial securities are insignificant and their medium and long-term advances are also very small, there is one direction in which banks assist, indirectly, the capital market and that is through their advances against shares and debentures. Although such advances may be essentially for providing working capital, the fact that bank credit is available against the shares and debentures tends to encourage investment in industrial securities. At the time of new issues

also, bank finance is of some assistance. The data regarding these advances of scheduled banks are presented in Table 36. These advances have been rising steadily, though as a percentage of total advances they have remained more or less stable at 9-10 per cent.

TABLE 36

SCHEDULED BANK ADVANCES AGAINST SHARES AND DEBENTURES

(Rs. crores)

Date	Advances to sharebrokers and dealers	To others	Total
June 1956	13.24	46.86	60.10
December 1956	14.02	57.42	71.44
December 1957	9.75	63.50	73.25
December 1958	12.45	68.67	81.12
December 1959	14.58	76.61	91.18*

* As of end of December 1959, advances against shares amounted to Rs. 77.90 crores and against debentures to Rs. 13.29 crores.

The reasons for the non-participation of banks in the provision of long-term finance are obvious. Since the liabilities of the banking system are essentially short-term, they cannot afford to lock up their resources in long-term investment and thus reduce the liquidity of their assets. Besides, long-term investment against the security of fixed assets raises a number of difficult problems of administration, supervision and valuation for which the banks do not have adequate machinery. The argument regarding the liquidity of assets is partly conditioned by the lending policies and regulations of the central bank which is the lender of last resort to the banking system. Under the existing central banking legislation in India, commercial banks can only obtain funds for periods not exceeding 90 days. It is for this reason that the Committee on Finance for the Private Sector (the Shroff Committee) suggested the grant of facilities by the Reserve Bank to

the commercial banks for lending for longer-term on the analogy of the bill market scheme in respect of short-term advances.

Apart from the above considerations which are generally applicable to commercial banks all over the world, there has also been a feeling that the Indian commercial banking system has not yet reached a stage of stability from which it could venture into less orthodox types of activity. During World War II and in the immediate post-war years, the Indian banking system witnessed a phenomenal growth but it was not wholly a healthy one. There were elements of weakness in the system and the process of redeeming the unhealthy trends has been a long one. For this purpose the Banking Companies Act was passed in 1949 and only now can it be said that the banking system has attained a fair measure of stability and consolidation. In the result, till recently both official and public opinion has been against the entry of commercial banks into long-term financing. Rather, the idea has been that special institutions ought to be set up for the provision of long-term finance and the participation of banks in long-term financing should be confined to their contribution to the share capital and debenture issues of these special institutions. Accordingly, the Industrial Finance Corporation of India was set up in 1948 and from 1953 onwards State Financial Corporations have been set up in all the States. Banks, for instance, now hold about 25 per cent of the share capital of the Industrial Finance Corporation of India and 40 per cent of the share capital of the Refinance Corporation. Banks have also purchased a substantial portion of the debentures issued by the IFC and the State Financial Corporations.

While broadly the attitude towards banks' participation in term finance has remained the same, in the last few years there has been some rethinking on the subject, mainly on account of the larger requirements of capital for the private sector in connection with progressively bigger plans. Opinion has been gradually veering round to the view that upto a modest limit it may not only be all right but also desirable for banks to engage in medium-term financing. The Shroff Committee championed this view and, as mentioned earlier, suggested the grant, to scheduled banks, of rediscount facility at the Reserve Bank for medium-

term paper, though the Committee also warned against banks' learning too much upon the Reserve Bank. The Shroff Committee also suggested that banks should take an active part in the underwriting of or investing in new issues of shares and debentures in association with life insurance companies and that this might be done under the leadership of the then Imperial Bank of India. As mentioned in chapter 4, many changes have since taken place in regard to the various financial institutions and it may be taken that, at least for the time being, the idea of establishing a formal consortium has been given up, though about a year ago it was reported that Shri G. D. Birla suggested, at the meeting of the Central Advisory Council for Industry, the formation of a consortium for the underwriting of shares and that his proposal was favourably received by the Council.

However, banks appear to be increasingly participating in underwriting, either singly or in association with other banks and institutions, such as, the ICICI and the LIC (see Table 27). In chapter 4, reference has also been made to the establishment, in June 1958, of the Refinance Corporation, to provide refinance facilities to selected scheduled banks in respect of medium-term advances to medium-sized industrial units. It is expected that this institution will stimulate term lending by banks and that they would in due course use a part of their own resources for term lending; in fact, the official view appears to be that the Refinance Corporation is only intended to *supplement* the resources of banks for this type of activity.

In considering the subject of commercial banks' participation in term finance, we must look at the problem from the point of bankers as well as from the point of view of the growth of the economy. For the commercial banks, the main question is one of maximising earnings, consistent with a safe or liquid pattern of assets structure. Medium-term loans may not, by and large, be illiquid; in fact, they impose some discipline on the borrower to adhere to a definite schedule of repayment, unlike in the case of so-called short-term loans. As regards earnings potential, it is not certain if the return they could get on term lending could be significantly higher, by and large, than what they get on their short-term advances. Further, the suggestion for larger participa-

tion in term financing assumes that the commercial banks have such surplus resources as cannot be profitably employed either in short-term loans or Government securities. In a developing economy, the requirements of working capital to grow significantly and it is doubtful if banks are in a position to spare large funds for term lending. It is significant in this connection that the credit-deposit ratio of Indian banks, which now averages to about 65 per cent, is much higher than the corresponding ratio in many advanced countries. Therefore, purely from the point of view of the resources position of banks, there is not much scope for term lending by banks, apart from the propriety or otherwise of such lending. If banks were to reduce their short-term loans the prospective borrowers have to find alternate sources. What is important in this connection is the increase in the aggregate saving and investible resources of the community and not merely diversion from one channel to another. The chief merit of the suggestion for larger commercial banks' participation in term lending is the flexibility of operations of the commercial banks. This is an important consideration but does not by itself constitute an overwhelming argument in favour of term lending. In other words, the cautious approach which the Indian banks have so far been following is generally sound, such participation as they want to do in term financing being largely indirect through the finance corporations. The Refinance Corporation for Industry, to which a reference was made earlier, would provide, to a limited extent, the incentive to commercial banks to engage in term financing. It is well to recognise that if, in the interests of rapid industrialisation, Government or the Reserve Bank wants the commercial banks to engage in term lending, some assistance has to be given to them, in the form of either special Government deposits or rediscount facilities at the Reserve Bank. The Refinance Corporation seems to provide a satisfactory solution to the problem. At present the facilities of this Corporation are available only to the relatively big banks, but it may be hoped that in due course they would be extended to all scheduled banks.

Bank finance and small-scale industry

The difficulty in raising long-term finance for fixed assets is particularly felt by the relatively smaller industrial units. In fact, they have difficulty in obtaining bank loans for working capital

also. About three years ago, the Reserve Bank published* data of industrial advances of scheduled banks, as at the end of the year 1955, according to the size of the borrowing industrial unit, as measured by its total assets. The position was as under:

TABLE 37

INDUSTRIAL ADVANCES OF SCHEDULED BANKS

Borrowing Units with total assets	No. of accounts	Amount of advances (Rs. crores)	Percentage of amount to total
(i) Upto Rs. 1 lakh	6,867	6.69	3.0
(ii) Over Rs. 1 lakh but under Rs. 5 lakhs	2,664	17.14	7.8
(iii) Over Rs. 5 lakhs but under Rs. 20 lakhs	1,644	30.09	13.6
(iv) Over Rs. 20 lakhs	1,788	167.04	75.6
Total	12,963	220.96	100.0

* *Reserve Bank of India Bulletin,* November 1956.

It will be seen that industrial advances to the small-scale units (broadly groups (i) and (ii) above) constituted a relatively minor share of overall advances to industry. Recently, the Research Department of the Reserve Bank carried out a sample survey of scheduled bank advances to small and medium-sized business units as on September 30, 1957**. It was estimated that as on that date, while advances of all types to the small and medium units amounted to Rs. 242 crores (or about a little over 30 per cent of the total credit of banks), the advances for *industrial* purposes were very small, namely Rs. 49 crores (including utilities) or a little over 20 per cent, as compared to the ratio of about 45 per cent in respect of the aggregate advances of banks to all borrowers, big and

** *Reserve Bank of India Bulletin,* June 1959.

small. Looking at the figures from another angle, of the total *industrial* advances of scheduled banks, advances to small and medium-sized units accounted for only about 14 per cent. This is even a smaller percentage than that indicated by the December 31, 1955 data, though it should be noted that the September 30, 1957 figures are estimates. Further, breakdown between 'small' and 'medium' sectors are not available for the 1957 data. In any event, the above figures bring out clearly the small share of the small units in aggregate bank credit, which in India is provided mostly for working capital.

It should be noted that the above percentages relate to the overall position of medium and small units. In the case of some individual industries or in the case of selected places, the *proportion* of bank advances to these units may not be insignificant, though in such cases the absolute amount of the loan itself would probably be small.

The difficulties of the small industrial units in getting long-term capital are naturally greater than in regard to meeting the requirements of working capital. This is of course to a large extent due to the inherent character of the small-scale units, whose difficulties are as much (if not predominantly) non-financial as financial. These difficulties will diminish to a large extent by the development of large-scale units, as a result of which the small-scale units will have plenty of scope to develop as ancillary units. This process is taking place. Also, it should be recognised that in many cases, small units are set up so that control may vest in a few hands only; this being so, the people in charge of these cannot complain of difficulties in obtaining outside capital. This is not to say that institutional arrangements should not be improved for the provision of capital to the small-scale industrial units. In fact, in the last few years, action has been initiated in this behalf. Apart from direct lending by Government. (which is likely to diminish in favour of channelling it through the special institutions) State Financial Corporations and to a small extent the National Small Industries Corporation have been set up for the purpose of providing long-term funds (see chapter 6 for details). In this chapter we are primarily interested in the role

of commercial banks particularly in the provision of term finance, though the measures taken are such as to cover both types of finance, that is, short-term as well as long-term.

In regard to the role of banks in the financing of small-scale industry, two important developments have to be mentioned. The first is the 'Pilot' Scheme* of the State Bank of India and the other is the proposal to institute a system of guarantee for bank loans to industrial units. The essence of the pilot scheme, which was inaugurated in 1956 as an experimental measure in 9 centres and which in 1959 was extended to all the offices of the State Bank, is the provision of co-ordinated finance to small-scale industrial units. Despite the existence of a variety of credit agencies, the flow of finance of various types to the small-scale industries sector was impeded due, among other reasons, to the lack of co-ordination of the activities of these credit agencies. The need for the small industrialist to apply to a multiplicity of agencies for his financial needs would involve delay and expense. Moreover, the State Financial Corporations and the National Small Industries Corporation did not have a widespread network of branches which rendered it difficult for industries in the remote towns and villages to contact them. There was also avoidable duplication of the initial investigation of the potentialities of the borrower's business by each credit agency. Moreover, a local agency in charge of all types of credit is in a position to exercise better supervision over the use made of the finance than a number of agencies situated far away. These various considerations pointed to the need for an arrangement which would deal with the total credit needs of the borrower and arrange for the supply of each type of credit by the concerned institution.

Under the Scheme, a borrower is required to apply to the Agent of the State Bank (or of the local co-operative bank if he belongs to the co-operative sector) for *all* his credit requirements. The application is dealt with by a Local Working Group consisting of representatives of the agencies working the scheme; this Group refers the application to the appropriate agency, depending upon the type of credit asked for. Ordinarily, application for loans

* The material on this is mostly extracted from the papers prepared for the Seminar on the Financing of Small-Scale Industries, organised by the Reserve Bank of India in July 1959.

below a particular amount (Rs. 10,000 or Rs. 20,000) will be taken up by the Director of Industries under Government's liberalised scheme for financing small-scale industries, while applications over this amount are dealt with by the concerned State Financial Corporation if they are for medium or long-term credit. However, applications for loans for working capital purposes are ordinarily dealt with by the State Bank or the co-operative banks; if the accommodation required is both short and long or medium term, the agencies concerned act in collaboration. The State Bank or the co-operative bank, as the case may be, gives the necessary assistance to the other financing agencies in assessing the credit-worthiness of the party. The Directors of Industries or the representatives of the Small Industries Service Institute give assistance in regard to furnishing a technical report on the industrial unit. Applications which the various agencies are not able to entertain normally are further considered in order to find out how best the needs of the borrower can be met.

In this connection, the State Bank has entered into agency arrangements with the West Bengal, Uttar Pradesh and Bombay State Financial Corporations under which the Bank will act as their agent in collecting credit reports, disbursing loans, collecting instalments etc. Similar arrangements are being negotiated with the Andhra Pradesh and Punjab Financial Corporations. This would enable the Corporations to enlarge their sphere of activity and meet more effectively the credit requirements of industrial units.

By the end of February 1959, the Bank had sanctioned credit limits of Rs. 2.63 crores to 795 parties, under the scheme; by the end of November, this had risen to Rs. 3.76 crores. The above limits were spread over a wide variety of industries, the most prominent being the engineering units.

Experience gained in the working of the scheme revealed that unless the State Bank liberalised its procedure and practices, it would not be possible to assist small-scale industries to any appreciable extent. Accordingly the Bank's procedures were liberalised, whereby credit facilities are now extended to small industries at the pilot centres for working capital purposes against the pledge of raw materials and/or finished goods, either on lock-and-key or factory-type basis or against hypothecation of stocks.

The interest charged by the State Bank on loans under the Pilot Scheme is linked to the State Bank's *prime advances rate,* which at present is $4\frac{1}{2}$ per cent per annum. Interest is charged on a sliding scale, the lower reach of which is applicable to advances against stocks under the Bank's lock and key. The rates on factory-type and hypothecation advances are slightly higher while the highest rate is applicable to clean credits.

The State Bank recently entered into an agreement with the National Small Industries Corporation Ltd., under which small-scale industries securing orders from Government departments etc., through the auspices of the Corporation, would be able to avail themselves of advances from the Bank at all its branches against pledge of raw materials upto their full value, the portion of the advance representing the Bank's usual margin being guaranteed by the Corporation. The Corporation has, however, stipulated that the guarantee in individual cases will not exceed Rs. 25,000 and that the limit of its overall guarantee will be restricted to Rs. 30 lakhs. The scheme came into operation with effect from January 1, 1959. The working of the arrangement will be reviewed early in 1960.

The State Bank recently conducted an evaluation of the results of the working of the scheme upto the end of December 1957 at the 9 centres where it was first introduced. The evaluation was that although the progress achieved at all the 9 centres was neither remarkable nor uniform, the scheme had, on the whole, worked fairly well and had an assured place in the field of providing improved credit facilities to small-scale industries. The State Bank has also accepted some of the recommendations made in the evaluation report. As already mentioned, the liberalised scheme has been extended by the Bank to all its branches. It will, however, be worked more intensively at certain important centres with a view to achieving maximum co-ordination with the other participating agencies. The interest on the advances has been fixed at an all-inclusive rate not exceeding 6 per cent per annum, without imposing on the borrowers any additional charges viz., godown keeper's salary, inspection charges etc. In appropriate cases, the Bank has expressed its readiness to grant medium-term loans to small-scale industrial units for expansion or renovation for periods

not exceeding seven years upon such security (including the security of any immovable property) as may be deemed adequate by the sanctioning authority. So far, the Bank has not granted any medium-term loan to small industries.

Another notable development concerning bank finance for industry is the proposal to institute a system of guarantee for bank loans, in order to encourage flow of bank lending to small-scale industry. The idea took shape at the Seminar on the Financing of Small-Scale Industries organised by the Reserve Bank in July 1959 at Hyderabad and it is reported that the scheme will come into operation on April 1, 1960, on an experimental basis. The scheme is based on the premise that the flow of bank finance to the small-scale industrial units is small not because of inadequacy of resources but because the risk involved in such lending is large, especially as regards term-lending, and that if a system of guarantee is instituted, the flow of bank assistance will rise significantly. Such schemes are in operation in some foreign countries, for instance, Japan and the U.S.A.

The outline of the scheme seems to be as under. The scheme is to be tried, in the first instance, in 21 selected districts, and is to be extended to 42 districts in the second year of operation. The facility of guarantee is to be made available to selected commercial banks and apex co-operative banks. The other banks will also be eligible for guarantee facilities, provided not less than 25 per cent of the loan is either guaranteed or participated in by any-one of the selected banks, commercial or co-operative. The guarantee facility is to be made available in respect of short-term as well as medium-term loans not exceeding generally 7 years.

The details of the extent of guarantee are as under. The guarantee will be in two parts, one full and the other partial. Loans upto Rs. 25,000 will carry a 20 per cent full guarantee; above Rs. 25,000, the full guarantee is for 10 per cent of the loan or Rs. 5,000, whichever is higher, subject to a maximum of Rs. 50,000. Any loss in excess of the above full guarantee will be shared equally between the guarantee organisation and the lending bank, provided that the guarantee organisation's total liability in respect of any one loan does not exceed Rs. 1 lakh. Thus, the percentage of guarantee is larger for relatively small loans.

In the pilot stage, the guarantee scheme will be administered by the Reserve Bank of India, though the ultimate liability for the loss arising from guarantee will be that of the Central Government. In the pilot stage a guarantee fee, of one-fourth of one per cent, would be levied, though this rate may be modified when the scheme is put on a permanent basis. It is reported that the broad outline of the scheme was approved at the meeting of the All-India Small-Scale Industries Board held in October 1959. The total expansion of credit likely to be achieved at the selected districts at the end of two years is estimated at Rs. 5 crores, from Rs. 10 crores to Rs. 15 crores. Further procedural details will, it is learnt, be finalised after discussion with bankers.

There is no doubt that the guarantee scheme will lead to expansion of bank credit to the small-scale units, though it is difficult to forecast to what extent. It seems to be largely a question of bank resources; it is doubtful if they are adequate for any significant expansion to the small units, especially for meeting fixed capital requirements, which is the type of lending with which we are principally concerned in this book. Further, it is not likely that the mere provision of guarantee will make the bigger banks take much interest in the financing of small-scale industries. It is only the small banks that are likely to take considerable interest in the financing of small-scale units, but, for this purpose, they would require not merely guarantee but also additional resources. It is not known to what extent the small banks would be extended the guarantee facility, in view of the greater difficulty of supervision and the likelihood of larger risks involved. Further. even if small banks go in for larger *short-term* financing out of their own resources, they may not be in a position to provide *medium-term* finance, without rediscount facility. One gathers the impression that the authorities are not in fact keen on the small banks' going in for term finance on any extended scale*. Furthermore, the way the Indian banking system is developing, the smaller banking units seem to be declining in importance.

* Vide the remarks of the Governor of the Reserve Bank and Chairman of the Refinance Corporation at the first annual general meeting of the Corporation — "It would seem to be advisable for the present that the smaller banks confine themselves to the known hazards of commercial lending till some experience has been gained by the bigger banks of the problem of industrial lending"

All this means that the State Bank of India (and its various subsidiaries) would have to take the primary responsibility for augmenting the supply of credit to the small-scale industrial units. Administratively too it should be simpler than dealing with a number of banks under the guarantee scheme. Further, to some extent, the State Bank of India will inevitably have to engage in 'mixed' banking, i.e. provide short-term as well as medium-term credit. For this role, the State Bank of India is eminently suited. Its resources are substantial; it has an excellent record for soundness and efficiency; it has a large number of branches; finally, its policies are subject to a large measure of influence and direction of Government and the Reserve Bank.

The above developments, namely, the establishment of the Refinance Corporation, the launching of the pilot project and the institution of a system of guarantee for bank loans to small-scale industrial units would no doubt have an impact on the operations of other special financial institutions, namely, the State Financial Corporations, the Industrial Finance Corporation of India and the Industrial Credit and Investment Corporation of India. Ordinarily the preference of borrowers would be to go to a bank rather than a finance corporation for the requirements of term finance. However, since we do not expect much provision of term finance by banks to the small-scale industrial units, the State Financial Corporations may not be affected much. But the activities of the Refinance Corporation are likely to affect the business of the IFC and the ICICI, though in view of the larger magnitude of investment in the Third Plan, all the special institutions should have brisk demand for their assistance. In any event, the institutional set-up for the provision of capital to industry will have to be reviewed in the light of the experience gained.

It may be asked whether, apart from the provision of term *loans*, there is not a case for a larger volume of *investment* of bank funds in shares and debentures of joint stock companies, as suggested by the Shroff Committee. The answer is, 'not much'. There is undoubtedly little risk in banks' investing a larger percentage, say 5-10 per cent, of their deposits in shares and debentures of *good* companies; but such companies do not ordinarily experience difficulty in raising capital. It is only the new companies, especially those which are not associated with any leading manag-

ing agency firm, as well as the relatively small companies that are in need of assistance. There is obviously risk in the banks' buying shares of such companies and to guard against this, detailed restrictions would have to be laid down in the matter of such investments. As a matter of fact, even in the case of investment of life insurance funds there have been stringent regulations in the matter of investment in industrial securities, especially shares. It is also significant that the special long-term financial institutions, namely, the Industrial Finance Corporation of India and the State Financial Corporations are prohibited from investing in shares. In the circumstances there is not much point in expecting banks to purchase shares to any significant extent. As already mentioned, some of the leading banks have been engaging in underwriting operations, mostly in respect of debenture and preference share issues, and these may be expected to grow in volume in the years to come. There is scope for some enlargement of the investment of bank funds in debentures, which now constitute less than one per cent of the total investments of banks, but the difficulty is that debenture issue is relatively unimportant in India. However, with the change in the system of corporate taxation, i.e. the so-called discontinuance of the grossing up of dividend income, the issue of debentures is likely to grow and banks may be expected to invest a somewhat larger portion of their funds in these securities.

Chapter 6

SPECIAL FINANCIAL INSTITUTIONS

Opinion in India, as already mentioned in the previous Chapter, has generally favoured the establishment of special institutions for the provision of medium and long-term finance to industry. Soon after the Second World War and especially after the attainment of freedom the urgency of proceeding with large scale industrial development led to the establishment of a number of special institutions, beginning with the Industrial Finance Corporation of India. It would appear that the establishment of two corporations in U.K. for provision of finance for industry stimulated thinking in India on similar lines. Besides the Industrial Finance Corporation of India, the other long-term financing agencies in existence in India now are 13 State Financial Corporations, the Industrial Credit and Investment Corporation of India, the National Industrial Development Corporation, the Refinance Corporation for Industry and finally the National Small Industries Corporation. While there is much in common as regards the objectives of these corporations, there are also important differences in regard to capital structure, share ownership, Government control and scope of lending. The existence of a number of corporations has also raised important questions of co-ordination of policies. In commenting on the work of these institutions, regard must be had to the fact that many of these have been in existence for a few years only. The general impression that one gets is that their performance is not unsatisfactory. It is not proposed to make any detailed assessment of the working of these corporations; that would require a very elaborate enquiry into their working. We may begin the study with the Industrial Finance Corporation of India (IFC) which is the oldest of the special institutions.

(a) THE INDUSTRIAL FINANCE CORPORATION OF INDIA

The IFC was established in July 1948 under the Industrial Finance Corporation Act, 1948, with a view to providing medium and long-term credit to industry, particularly in circumstances where accommodation from normal financial sources is inappropriate or recourse to the capital market is impracticable. Its assistance is, however, confined under the Act to *public limited* companies and co-operative societies, incorporated in India, engaged in manufacturing or processing of goods, mining, generation and distribution of electric power or any other form of power, shipping and hotel industries.

The Corporation's capital is held jointly by the Government of India, the Reserve Bank of India, the Life Insurance Corporation of India, scheduled and co-operative banks, insurance companies and investment trusts, the majority ownership being vested in the public sector; individuals cannot hold shares of the Corporation. It thus combines Government association and supervision with the benefit of experience of the banking and financial community.

Types of Assistance

The Corporation is empowered to provide financial assistance by (1) granting loans or advances to, or subscribing to the debentures of, industrial concerns, repayable within 25 years, (2) guaranteeing loans floated in the open market by industrial concerns, repayable within 25 years, (3) underwriting of stocks, shares, bonds or debentures issued by industrial concerns, subject to the stocks etc. acquired as a result of underwriting being disposed of in the market within a period of 7 years* and (4) guaranteeing deferred payments in respect of imports of capital goods by approved industrial concerns who are able to make such arrangements with foreign manufacturers.

Accommodation of the first two types cannot be granted unless it is sufficiently secured by the pledge or mortgage of gov-

* This limitation can be waived with the permission of the Union Government.

ernment or other securities, bullion or movable or immovable property or unless it is guaranteed as to the repayment of principal and the payment of interest by the Central Government, State Government, a scheduled bank or a State Co-operative Bank. The Corporation demands collateral valued at twice the amount of the loan.

Prior to December 1952, no single industrial concern was entitled to get assistance exceeding 10 per cent of the paid-up capital of the Corporation or Rs. 50 lakhs whichever was less, in terms of Section 24 of the principal Act. An amendment made in December 1952, however, raised this limit to an amount not exceeding Rs. 1 crore in the aggregate and the Corporation was further authorised to make advances exceeding Rs. 1 crore to a single concern if the loan was guaranteed by the Government of India. At present, the *minimum* assistance which the Corporation provides is Rs. 10 lakhs, except in the case of supplementary loans to existing clients.

Since the main intention in establishing the Corporation was that it should assist industrial concerns in obtaining capital and not act as a holding company or an investment trust, it is prohibited in terms of Section 26(b) of the Act from directly subscribing to the shares or stock of any company having limited liability. Thus, the Corporation is empowered to provide loan capital and not equity capital.

Resources

The authorised share capital of the Corporation is Rs. 10 crores divided into twenty thousand shares of five thousand rupees each. Of this, ten thousand shares of the total value of five crores of rupees have been issued in the first instance, and are fully paid-up. The distribution of ownership of shares as on June 30, 1959, the latest date for which the data are available, was as under.

TABLE 38

DISTRIBUTION OF SHARES OF THE IFC

Shareholder	No. of Shares	Amount Rs. lakhs	% to total
Government of India	2,000	1,00	20.0
Reserve Bank of India	2,054	1,03	20.6
Scheduled Banks	2,405	1,20	24.0
Co-operative Banks	945	47	9.4
Insurance Companies etc.	2,596*	1,30	26.0
Total	10,000	5,00	100.0

* Of these 2,346 shares are vested in the Life Insurance Corporation of India, consequent upon nationalisation of the business of life insurance.

It will be seen that two-thirds of the share capital is owned by the Central Government and organisations in the public sector, including the Life Insurance Corporation.

The shares of the Corporation are guaranteed by the Government of India as to the repayment of the principal and the payment of a minimum annual dividend of 2.25 per cent.** The rate of dividend cannot exceed the rate guaranteed by the Government until the reserve fund is equal to the paid-up share capital and until the Government has been repaid all the amounts paid by it in fulfilment of the guarantee liabilities and in no case can the rate of dividend exceed 5 per cent. Surplus net profits of the Corporation, after the payment of dividend, at the above maximum rate, accrue to the Government. The shares of the Corporation are included as trustee securities under the Indian Trusts Act and as approved securities for purposes of the Insurance Act 1938 and the Banking Companies Act, 1949.

** The amount of guaranteed dividend on the shares of the Industrial Finance Corporation of India and the State Financial Corporations was in effect free of income-tax until March 1959, since the Corporations used to pay income-tax and super tax on their profits and gains. In terms of the Finance Act, 1959, however, all Corporations are required to deduct income-tax at source from the dividends payable by them, except that the portion of dividend paid out of subvention from the Government would be exempt from tax. Whether the Corporation would so adjust their dividend distribution to maintain the previous tax-free return is a matter of policy, which will be decided in time before the distribution of the 1959-60 dividend. In the alternative, the Income-tax Act would have to be suitably amended; this is eminently desirable, since nobody had bargained for a taxable return of $2\frac{1}{4}$ — $3\frac{1}{4}$ per cent only.

The Corporation has powers to augment its resources through issue of bonds or debentures, which together with its contingent liabilities in the form of commitments under guarantees and underwriting agreements are not, however, to exceed *ten* times* the aggregate of its paid-up capital and reserve funds. The bonds and debentures are also guaranteed by the Government of India in respect of repayment of principal and payment of interest. The total bond issues at the end of June 1959 stood at Rs. 16.75 crores; there has since been a further issue of Rs. 5 crores in October 1959. Probably the bonds are held largely by banks. The Corporation may also accept deposits, with a minimum maturity of five years, from the public, State governments and local authorities†; the aggregate of such deposits, however, is not to exceed Rs. 10 crores. This business has not, however, been undertaken by the Corporation so far. Besides, the Corporation is authorised to borrow from the Reserve Bank against (a) securities of the Central or State Governments, repayable on demand or for fixed periods not exceeding 90 days and (b) bonds and debentures issued by the Corporation, maturing and repayable within 18 months, or against securities of the Central Government of any maturity provided the amount so borrowed shall not at any time exceed Rs. 3 crores in the aggregate and shall be repayable within 18 months. The maximum borrowing under (a) was Rs. 1.46 crores in September 1954, subsequent to which there has been no borrowing at all. Borrowing under (b) has been more frequent; the outstanding amount of such borrowing touched nearly Rs. 3 crores in December 1956 but declined more or less continuously from October 1957, being nil many times (Table 39). At the end of 1959 it was Rs. 1.62 crores. Further, the Corporation can also borrow from the Central Government, provided the total amount so borrowed, together with the outstanding bonds and debentures and borrowings from the Reserve Bank under (b) above shall not at any time in the aggregate exceed 10 times the paid-up capital and the reserve fund of the Corporation. The Government set apart a sum of Rs. 22.25 crores for this purpose in the Second

* Prior to the amendment of the I.F.C. Act, in November 1957, the Corporation's borrowings (including contingent liabilities) were limited to *five* times its paid-up capital and reserve funds.

† Prior to the amendment in November 1957, the Corporation was empowered to accept deposits only from the public.

TABLE 39

ASSETS AND LIABILITIES OF INDUSTRIAL FINANCE CORPORATION OF INDIA

(In Lakhs of Rupees)
As on June 30

	1949	1954	1958	1959
LIABILITIES				
1. Capital: Issued and Paid-up	5,00	5,00	5,00	5,00
2. Reserves:				
(a) General Reserve Fund	—	—	17	31
(b) Special Reserve Fund*	—	5	23	27
(c) Other Reserves†	—	10	16	16
3. Provision for Taxation**	2	18	6	25
4. Bonds and Debentures	—	7,80	12,37	16,75
5. Borrowings from the Reserve Bank of India:				
(a) Under Section 21(3)(a) of the IFC Act	—	1,23	—	—
(b) Under Section 21(3)(b) of the IFC Act	—	—	—	—
6. Borrowings from Government under Sectin 21(4) of the IFC Act	—	—	15,00	13,00
7. Borrowings in Foreign Currency	—	—	—	—
8. Fixed Deposits	—	—	—	—
9. Contingent Liabilities under Guarantees and Underwriting Agreements per contra	—	—	75	—
10. Other Liabilities	—	44	1,14	1,04
11. Profit and Loss Account Credit Balance	1	17	17	21
12. TOTAL	5,03	14,98	35,05	37,00

* Under Section 32(A) (1) of the IFC Act.

† Includes reserves for doubtful debts and contingency reserves.

* * Less Advance Tax paid.

TABLE 39 (Contd.)

(In Lakhs of Rupees)

	1949	1954	1958	1959
ASSETS				
1. Cash in Hand and with Bankers	34	18	3,84	1,58
2. Investments in Government Securities	3,32	2,00	—	—
3. Call Deposits	—	—	—	—
4. Loans and Advances	1,33	12,10	28,94	33,37
5. Debentures	—	—	—	66
6. Guarantees & Underwriting Agreements	—	—	75	—
7. Other Assets	5	70	1,52	1,40
8. TOTAL	5,03	14,98	35,05	37,00

Plan and recently an additional sum of Rs. 10 crores was allotted out of the P. L. 480 funds. The outstanding borrowing of the Corporation from the Government which began in November 1956 has shown fluctuations; it reached Rs. 15 crores in March 1958 and after declining to Rs. 10 crores by December 1958 increased to Rs. 13 crores at the end of April 1959 and stood at Rs. 6 crores at the end of 1959.

The Corporation is also empowered (with the consent of the Government of India) to borrow foreign currency from the International Bank for Reconstruction and Development or others, for making loans to industrial concerns requiring to be financed in foreign currency.

The Corporation is regarded as a company within the meaning of the Indian Income-tax Act, and is, therefore, liable to income-tax and super-tax.

Management

The management of the Corporation is entrusted to a Board of thirteen Directors (including the whole-time salaried Chairman), representing the Government of India, the Reserve Bank, schedu-

led and co-operative banks and insurance companies, investment trusts and other like financial institutions. The Board is assisted by a Central Committee. In discharging its functions, the Board is to act on business principles with due regard to the interest of industry, commerce and the general public and is to be guided by such instructions on questions of policy as may be given by the Government of India, and in regard to which Government's decisions are to be final. The Government of India has also the power to supersede the Board and appoint a new Board in its place if it fails to carry out Government's instructions.

Since 1955, there have been some important organisational changes in the Corporation, following the enquiry into its working by a special committee headed by Smt. Sucheta Kripalani.

In the course of the discussions on the Industrial Finance Corporation (Amendment) Bill, 1952, certain criticisms were made, in both the Houses of Parliament, on the working of the Corporation. The principal allegations were that of nepotism and favouritism in the grant of loans, particularly to big industries. The Government of India decided that these charges should be investigated by an impartial committee. The terms of reference of this committee were (1) to scrutinise the loan transactions of the Industrial Finance Corporation with reference to the allegations (referred to above), (2) to verify whether in general due care has been exercised in the grant of loans, (3) to review generally the policy followed by the Corporation in the grant of loans with due regard to the objectives of the Act and the directions issued by the Government and (4) to make recommendations, if necessary, for improvement in the working of the Corporation.

The Committee, which submitted its report in May 1953, made a number of general recommendations covering (i) administrative and organizational matters, (ii) procedural matters, and (iii) matters of policy. The recommendations were generally accepted by Government.

Implementation of some of the recommendations necessitated amendment of the Industrial Finance Corporation Act. Thus, with a view mainly to implementing Government's decision on the

Committee's recommendations dealing with administrative and organizational matters an amending Act, which came into force in September 1955, provided among others:

(1) Extension of the Act to the State of Jammu and Kashmir;

(2) Appointment of a stipendiary Chairman to be assisted by a General Manager in place of the Honorary Chairman and a paid whole-time Managing Director;

(3) Authority to the Corporation to borrow from the Central Government, (already referred to);

(4) Removal of limitation, with the permission of the Central Government, in respect of the period upto which the Corporation may hold any stock, shares, bonds or debentures in fulfilment of its underwriting liabilities (already referred to) and

(5) Right of the Corporation to lease the property pledged or mortgaged to it.

Further, to implement the Committee's recommendations on questions of policy, the Central Government issued, earlier in April 1954, the following instructions to the Corporation.

(i) The Board of the Corporation should occasionally meet at important centres like Bombay, Calcutta, Madras, etc., other than Delhi which is its headquarters.

(ii) Directors of the Corporation must invariably disclose whatever interest they may have in applications for loans (including shareholding in the loanee company or its managing agency) pending with the Corporation and the Directors concerned should withdraw from the meeting when the application for loan in which he is interested is under discussion.

(iii) The annual reports of the Corporation should be as informative as possible and should contain general reviews of development of industries particularly in the fields in which the Corporation has advanced loans. The names of borrowing concerns to whom loans are sanctioned should also be published in these reports.

(iv) In sanctioning loans, a minimum margin of 50 per cent should be generally aimed at and greater attention should

be given to the proper assessment of the earning capacity of the borrowing concern. The financial stakes of the Directors and the managing agents of the applicant concern should also be taken into account and where such financial stake has been taken into account by the Corporation as a factor of safety, the directors and the managing agents concerned should not be at liberty to dispose of their shareholdings in the borrowing concern without the prior approval of the Corporation.

(v) A report should be sent to Government with full particulars whenever loans in excess of Rs. 50 lakhs in individual cases are decided to be granted by the Corporation. A report should also be sent to Government of all cases of the grant of loans in which a Director of the Corporation is a managing director or a director/partner/shareholder in the managing agency concern of the applicant undertaking. In cases of loans to companies in which a Director of the Corporation is an ordinary director or shareholder, a report should be sent if loans are sanctioned at meetings at which less than half the Directors are present or the decision is not unanimous.

Lending Operations

Loans *sanctioned* by the Corporation have varied from year to year, the maximum annual sum being Rs. 15.1 crores in 1955-56, the smallest amount of Rs. 1.4 crores being in the year 1952-53. The rate of disbursements, however, rose sharply only from 1956-57 onwards, coinciding with the acceleration of the tempo of investment (Table 40). During the 11-year period 1948-59, the Corporation received in all 649 loan applications for a total amount of Rs. 136 crores; of these, 300 applications for an aggregate amount of Rs. 67 crores were sanctioned and 219 applications for an amount of Rs. 25 crores or 34 per cent of the applications were rejected. Of the sanctioned amount, it is stated that Rs. 10.5 crores have either been declined or are not to be made available. Upto June 30, 1959, the Corporation had disbursed Rs. 42 crores or 75 per cent of total effective loans, the outstanding loans and advances as on June 30, 1959 being Rs. 33 crores.

TABLE 40

TOTAL AMOUNT OF LOANS SANCTIONED AND DISBURSED BY THE IFC (Rs. Crores)

		Total amount of loans sanctioned	Total amount of loans disbursed
As at the end of 30th June,	1949	3.42	1.33
—do—	1950	7.19	3.41
—do—	1951	9.58	5.79
—do—	1952	14.03	7.57
—do—	1953	15.47	10.07
—do—	1954	20.74	12.89
—do—	1955	28.08	14.53
—do—	1956	43.21	16.73
—do—	1957	55.12	26.51
—do—	1958	62.90	34.84
—do—	1959	66.69	42.32

The actual commitments of the Corporation in respect of loans sanctioned upto the 30th June, 1959 are as follows:-

	(Rs. crores)
Total loans sanctioned	66.69
Amount disbursed	42.32
Loans declined or not to be made available	10.51
Total outstanding commitment	13.86

The Corporation would appear to have given the major part of its assistance to new undertakings, defined as factories that went into production after August 15, 1947; 185 applications (in respect of 107 concerns) from new undertakings were sanctioned loans aggregating Rs. 44 crores or 66 per cent of total loans sanctioned, during the 11-year period. Loans sanctioned to established undertakings for renovation, modernisation and expansion amounted to Rs. 23 crores, in respect of 115 applications, relating to 83 concerns.

The largest amount of loans sanctioned during the 11-year period was to sugar industry (Rs. 20.6 crores), followed by cotton textiles (Rs. 9.4 crores), chemicals (Rs. 8.5 crores), cement (Rs. 6.2 crores), paper (Rs. 5.7 crores), mechanical and electrical engineering (Rs. 4.1 crores), iron and steel-light engineering (Rs. 2.6 crores) and ceramics and glass (Rs. 1.9 crores). The Corporation has been specially asked by Government to encourage the establishment of co-operative factories, and for this purpose the Central and State Governments have agreed to guarantee nearly all the loans sanctioned by the Corporation to sugar co-operatives on a 50:50 basis. Hence the predominance of advances to the sugar industry.

As regards the State-wise distribution of loans sanctioned, Bombay came first, accounting for nearly 30 per cent of total loans sanctioned (during the period 1948-59), followed by Madras (about 14 per cent) and West Bengal (about 10 per cent); in the case of other States, it ranged from 5 to 8 per cent in the case of Orissa, Punjab, Kerala, Bihar, Andhra Pradesh, Mysore and Uttar Pradesh and 1 per cent in the case of Rajasthan and Assam.

In Table 41 is set out the classification of loans sanctioned by the Corporation according to size. Of the 300 applications sanctioned for loans aggregating Rs. 67 crores by the end of June 1959, the largest amount (Rs. 15 crores or 22 per cent in respect of 31 applications) was accounted for by class Rs. 40 — 50 lakhs. Since many companies were sanctioned more than one loan what is more significant is the size of loans per concern; the largest amount (Rs. 12.23 crores) in respect of 22 concerns was in the group Rs. 50 — 60 lakhs. 8 companies were sanctioned more than Rs. 1 crore each.

Normally, the Corporation's financial assistance is provided for acquisition of fixed assets, against the first mortgage of land, buildings, plant and equipment etc. The Corporation does not lend against raw materials or finished goods for acquiring working capital. It may relax the general policy in special circumstances. While the maximum period of repayment prescribed by the Act is 25 years, the Corporation does not ordinarily lend for periods exceeding 12 years, though the maximum period for which

it has lent is 15 years. The repayment of loans is made in equal or graduated instalments, beginning usually three years after the grant of loans.

TABLE 41

CLASSIFICATION OF LOANS SANCTIONED BY THE IFC

As on 30th June, 1959

	Amount sanctioned on each application		Amount sanctioned to each industrial concern	
	No. of Applications	Amount (Rs. lakhs)	No. of concerns	Amount (Rs. lakhs)
(i) Rs. 10 lakhs and below	125	7,91	49	3,02
(ii) Rs. 10—20 lakhs	73	11,45	41	6,43
(iii) Rs. 20—30 lakhs	28	7,53	26	7,00
(iv) Rs. 30—40 lakhs	25	9,49	15	5,67
(v) Rs. 40—50 lakhs	31	14,86	13	6,25
(vi) Rs. 50—60 lakhs	8	4,64	22	12,23
(vii) Rs. 60—70 lakhs	1	64	9	5,84
(viii) Rs. 70—80 lakhs	—	—	1	74
(ix) Rs. 80—90 lakhs	1	90	1	87
(x) Rs. 90 lakhs—Rs. 1 crore	5	5,00	5	4,92
(xi) Over Rs. 1 crore	3	4,27	8*	13,71
Total	300	66,69	190	66,69

* It was only in respect of 3 out of these 8 concerns that any single application was submitted for an amount exceeding Rs. 1 crore in each case. In respect of the other five, every one of the applications submitted was for *not more than* Rs. 1 crore, though the total of all the applications sanctioned in respect of each of these five concerns came to more than Rs. 1 crore in all.

Source: Eleventh Annual Report of the Industrial Finance Corporation of India.

Until about a year and a half ago, the Corporation did not do any underwriting of issues of industrial concerns. The reasons, according to the Corporation, for this are two-fold: firstly, the unsatisfactory state of the capital issue market in the country and secondly, uncertainty in regard to adequate response from the public.

The relevant passages from the annual reports for the years 1948-49, 1949-50 and 1950-51 are reproduced below:

> "In view of the present situation in the money market and the stock exchanges, the Corporation does not consider it advisable to undertake underwriting commitments for the time being. The Corporation would be justified in underwriting an issue of shares or debentures only if it was reasonably satisfied that there was likely to be an adequate response from the public and the market." (Report for 1948-49, p. 14).

> "The Corporation considers that conditions of sufficient confidence have not yet been established in the money market to warrant underwriting operations being undertaken at present" (Report for 1949-50, p. 20).

> "On account of the conditions prevailing in the money market and the stock exchange, the Corporation did not consider it advisable to undertake underwriting commitments. When the situation improves and if suitable propositions are received, the Corporation may undertake underwriting operations" (Report for 1950-51, p. 3).

Recently, the Corporation underwrote, for the first time, jointly with two other financial institutions, the issue of $6\frac{1}{2}$ per cent (subject to tax) redeemable and convertible debentures for Rs. 1.60 crores by a borrower concern from whom a loan of Rs. 45 lakhs was outstanding and the corporation's share of the commitment under the arrangement was Rs. 75 lakhs. In fulfilment of the underwriting obligations, the Corporation subscribed to the debentures to the extent of Rs. 65.85 lakhs and out of the proceeds of the debenture issue the loan of Rs. 45 lakhs was repaid. The Corporation also underwrote, jointly with two firms of stock and share-brokers, a $7\frac{1}{2}$ per cent tax-free Redeemable Cumulative Preference share issue of Rs. 50 lakhs of a new in-

dustrial concern; the Corporation's share of the underwriting arrangement was Rs. 37.50 lakhs. The issue was heavily oversubscribed. Another application from an existing concern for underwriting its issue of 7 per cent tax-free Redeemable Cumulative Preference shares for Rs. 50 lakhs has also been sanctioned by the Corporation. This brings the total amount of underwriting approved by the Corporation upto June 1959 to Rs. 162.50 lakhs.

Lending Rates

Until February 1952, the Corporation's lending rate was 5½ per cent with a rebate of ½ per cent for prompt payment of interest and instalments on due dates, the effective rate thus being 5 per cent. The rate was, however, raised in February 1952 to 6 per cent, the rebate for punctual repayment remaining at ½ per cent. In view of the increase in the rates of interest at which it has to raise resources, the Corporation's lending rate was further raised by ½ per cent to 6½ per cent in 1952-53 and again by ½ per cent to 7 per cent, effective April 23, 1957, with the usual rebate of ½ per cent for payment of interest and instalments on due dates. Thus, the effective lending rate of the Corporation now stands at 6½ per cent. The Corporation's lending rates have to be approved by Government. The Corporation also charges a commitment fee of 1 per cent but waives it where the delay in drawing is caused by circumstances beyond the borrower's control.

Financial Results

With the progressive expansion of the activities of the Corporation, its income, expenditure and net profits have shown a continuous increase. Between 1948-49 and 1958-59, these items showed increases, respectively, from Rs. 5.73 lakhs, Rs. 2.87 lakhs and Rs. 0.86 lakh to Rs. 203.88 lakhs, Rs. 130.80 lakhs and Rs. 35.37 lakhs. Except during 1952-53, the profits of the Corporation were insufficient to pay the guaranteed dividend, till the year 1955-56, with the result the Corporation had to rely upon the Government of India for subventions to the extent of Rs. 53 lakhs. The Industrial Finance Corporation (Amendment) Act, 1952 made provision for the creation of a special reserve fund to which all dividends accruing on the shares of the Corporation held by the Central Government and the Reserve Bank are to be credited,

instead of being paid to them, until the special reserve fund exceeds Rs. 50 lakhs. At the end of June 1959, the special reserve fund stood at Rs. 27 lakhs.

Appraisal

In assessing the working of the Corporation during a period of 11 years there would be general agreement with the observation of the Corporation's Chairman at the 10th annual general meeting, namely, "A decade is but a short period in the life of an institution like ours, particularly in a field like industrial financing of a long-term nature in which, at the time our Corporation was set up in 1948, we were the pioneers. It is, therefore, perhaps too early yet to draw any firm conclusions of a general nature from such *modest* (italics supplied) achievements as stand to our credit at the end of this ten-year period." In the beginning, the progress of the Corporation was inevitably slow. Apart from the fact that the Corporation had to get geared to the work, much was to be desired regarding the quality of applications for loans. But in the last few years the Corporation's activities have gathered momentum, judging from both the loan amounts sanctioned and disbursed. It is gratifying that at last the Corporation has ventured into the field of underwriting. There does not appear to have been much justification for its view in the earlier years that it did not underwrite because conditions in the capital market were not favourable for underwriting, which is on par with a doctor's statement that he would not attend on a person so long as that person was ill! The fact of the matter is that in the beginning the Corporation wanted to play safe, which one can appreciate, though not the reason that was given out for the underwriting inactivity. Also, in those years the resort to the Corporaion for loan assistance too was not much. Anyway, as already mentioned, there has been marked progress in this field recently.

It is very difficult to say if the bulk of the Corporation's assistance has gone to companies which otherwise would have found it extremely difficult to raise funds. The Corporation does not appear to be insisting that borrowers must come to the Corporation only after exhausting possibilities of borrowing elsewhere, though from the point of view of the Corporation's own interests one can understand its desire to seek a fair share of

'good' borrowers. It is satisfactory to know that the major portion of loans was sanctioned for 'new' undertakings; it may be hoped that the Corporation has tried to help new lines of activity, which ordinarily would find it difficult to raise capital elsewhere. In this connection, one is surprised to note the large portion of sugar advances. It would appear that in recent years the Corporation has in effect become Government's agency to channelise money to the co-operative sugar factories. While there is nothing wrong in this, there is need to devote greater attention to assisting units that are trying to explore new fields, consistent with the Plan objectives. It is of course possible that during this period applications from industries other than sugar have been comparatively few in which case the sugar loans would not have been made at the expense of other loans.

The amount of funds which the Corporation has lent so far is by no means very impressive, in relation to the order of investment in the private sector. But it should be borne in mind that it is essentially a marginal lender. The indications are that the scale of operations is bound to grow not insignificantly in the coming years, though it is necessary that the assistance of the Corporation should be more diversified. In particular, it must expand its underwriting operations significantly. It must also enter into arrangements whereby its loans could be converted into equity capital in suitable cases, for which an amendment of the Act governing the Corporation would be necessary. Although any significant contribution by the Corporation in the way of equity capital has to be ruled out, it would appear that there is no need for a total prohibition of investment in shares, especially of new companies. The operations of a specialised institution like the IFC should be flexible; since it works very much under Government supervision, there need not be much fear of the possible misuse of the Corporation's funds. It is gratifying to learn from the Chairman's speech at the eleventh annual general meeting of the Corporation that the Corporation is examining the feasibility of entering the above lines of activity. It is also reported that the Chairman is thinking in terms of participation in the profits of the borrowing company, over and above the interest charge. No amendment of the Act is needed for this. In judging the activities of the Corporation, one should keep in mind that it

has to obtain Government's approval for many things and that Government too has to be cautious, having regard in particular to the appointment of a parliamentary Committee to enquire into the Corporation's working in 1952.

(b) STATE FINANCIAL CORPORATIONS*

At the time of the enactment of the Industrial Finance Corporation Bill in 1948, it was recognised that the all-India Corporation, to be set up under it, would not be able to cater to the needs of all types of industries and that its sphere of activities would have to be necessarily confined to large-scale industries. Financial assistance to be granted by it was, therefore, deliberately limited to *public* limited companies or co-operative societies engaged in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power. It was made clear then that it would be necessary to set up more or less similar corporations in the States for financing small-scale industries, including *private* limited companies and other private enterprises, besides public limited companies or co-operative societies. The State Governments also desired that such Corporations should be established under a special statute in order to enable the incorporation, in their constitution, of provisions in regard to majority control by Government and the Reserve Bank, guarantee by the State Government of the repayment of principal and payment of a minimum rate of dividend on their shares, restriction on distribution of profits and special powers for the enforcement of claims and recovery of dues. Accordingly, the State Financial Corporations Act was passed by Parliament on September 28, 1951, as an enabling measure, under which State Financial Corporations (SFC) could be established. Provision was also made to bring within the scope of the Act any institution already in existence and concerned with the financing of industries. This was done at the instance of the Madras Government, which desired to bring within the scope of this Act the Madras Industrial Investment Corporation Limited, which had been incorporated under the Indian Companies Act in March 1949, Although the State Financial Corporations Act has not as yet been

* A good part of the material of this section is reproduced, with more up to date statistics, from an article on the subject appearing in the *Reserve Bank of India Bulletin*, December 1958.

made applicable to the Madras Industrial Investment Corporation, State Financial Corporations have been taken as including the Madras Corporation, unless otherwise indicated.

The first Corporation set up under the Act was the Punjab Financial Corporation, which was established on February 1, 1953. There were six Corporations at the end of 1953-54, ten Corporations at the end of 1954-55 and as many as thirteen Corporations functioning by the end of 1955-56, the accelerated tempo of economic activity towards the end of the First Five-Year Plan probably speeding up their formation in the latter years. Consequent upon the changes resulting from the reorganisation of States and including the Madras Industrial Investment Corporation Ltd. the number was reduced to twelve, that is, all States except Mysore and Jammu and Kashmir.* Recently, the Mysore Government also set up a Financial Corporation for the State.

Resources

The State Financial Corporations Act enables each State Government to fix the *authorised* capital of its Corporation, subject to a minimum of Rs. 50 lakhs and a maximum of Rs. 5 crores. The actual authorised capital of the existing Corporations ranges between Rs. 2 crores and Rs. 4 crores, as many as ten out of the thirteen having an authorised capital of Rs. 2 crores each. Two Corporations (Andhra Pradesh and Bombay) have an authorised capital of Rs. 4 crores each and one (Uttar Pradesh) of Rs. 3 crores. As regards *paid-up* capital, the Bombay Corporation has the largest amount at Rs. 2 crores, while at the other end stands the Orissa Corporation with Rs. 50 lakhs. The rest of the Corporations have a paid-up capital of Rs. 1 crore each, except the Andhra Pradesh State Financial Corporation and the Madras Industrial Investment Corporation Ltd. with Rs. 1.50 crores and Rs. 1.32 crores, respectively. Taking all the Corporations together, out of an aggregate authorised capital of Rs. 31 crores, Rs. 14.32 crores has been paid up.

While only Government, the Reserve Bank and financial institutions can participate in the share capital of the Industrial Finance Corporation of India, the general public can also sub-

* It is learnt that a Corporation is being set up for Jammu and Kashmir.

scribe to the share capital of the State Financial Corporations, though subject to a maximum of 25 per cent of the total. As on March 31, 1959* the State Governments accounted for 47.3 per cent (Rs. 6.76 crores), the Reserve Bank for 15.1 per cent (Rs. 2.16 crores), financial institutions like scheduled and co-operative banks, insurance companies and investment trusts for 33.2 per cent (Rs. 4.74 crores) and the general public for the remaining 4.4 per cent (Rs. 63 lakhs). Individual corporations, however, show very wide variations in the distribution of their paid-up capital among the different categories of shareholders. The participation of the State Government, for instance, ranges from 79 per cent in the case of the Madras Corporation and 70 per cent in the case of the Orissa Corporation to around 30 per cent in respect of the Bombay and West Bengal Corporations. The share of the Reserve Bank varies between 13 per cent and 21 per cent, except in the case of the Madras Corporation in which it has no share. Financial institutions account for almost one-half of the total paid-up capital in Bombay as against only one-tenth in Orissa. The contribution by the general public in no case exceeds 10 per cent of the total, although, as we have seen, the maximum statutory limit is 25 per cent.

As mentioned at the outset, the share capital of each Corporation is guaranteed by the State Government concerned as regards the repayment of principal and the payment of an annual dividend at the minimum rate fixed by the State Government in consultation with the Central Government. The rate of guaranteed dividend is 3½ per cent for all Corporations except the Punjab and Madras Corporations, in whose case it is 3 per cent and the Mysore Corporation, 4 per cent; the different rates reflect the pattern of interest rates at the time of the establishment of the Corporations. Further, the rate of dividend paid by a Corporation cannot exceed the minimum rate guaranteed by the State Government so long as its reserve fund is less than its paid-up capital and until the State Government has been repaid any sum it might have paid under the guarantee given in respect of the shares or bonds or debentures issued by the Corporation. The maximum

* The data for Madras Corporation are as of March 1958; the data also include shares of Mysore Corporation, though these were actually issued in May 1959.

rate of dividend payable by a Corporation is limited to 5 per cent by the Act and any surplus in the net profits after payment of dividend at this rate accrues to the State Government.

Besides raising share capital, the Corporations can also float bonds or debentures and accept deposits from the public in order to secure additional resources. With the growth in the volume of their lendings, the Corporations have, of late, resorted to the issue of bonds to augment their resources. The total amount of bonds issued by seven Corporations outstanding at the end of March 1959 was Rs. 6.12 crores.

The Corporations are required to consult the Reserve Bank in regard to the issue of bonds and debentures, in order to ensure due regard being paid to the conditions of the market and the proper co-ordination of the borrowing programmes of Governments and the Corporations. As in the case of their share capital, the bonds and debentures of State Financial Corporations are guaranteed by the State Governments concerned as regards repayment of principal and payment of interest. Besides, the State Financial Corporations Act limits the amount of bonds and debentures which a Corporation may issue. Thus, the total amount of bonds and debentures issued and outstanding and of the contingent liabilities of a Corporation in respect of guarantees given by it or underwriting agreements entered into by it cannot exceed *five* times the amount of its paid-up share capital and reserve fund. There is no provision in the State Financial Corporations Act for borrowing from State Government. The Madras Corporation has taken temporary loans from Government, such outstanding loans amounting to Rs. 40 lakhs at the end of June 1958. Outstandings at the end of March 1959 were nil.

The Corporations may accept deposits from the public. Such deposits are repayable only after a minimum period of five years because of the medium and long-term nature of the credit provided by the Corporations. Further, the total amount of such deposits is not to exceed the paid-up capital of a Corporation. So far, only two Corporations have accepted deposits, namely, Kerala and Madras. The outstanding of such deposits as at the end of March 1959 was Rs. 1 lakh in the case of Kerala and Rs. 2.06 crores in the case of the Madras Corporation, which accepts deposits for periods of from 1 to 20 years.

The Corporations are also permitted to borrow from the Reserve Bank against the securities of the Central or State Governments. Such loans are repayable either on demand or at the end of fixed periods not exceeding 90 days. With the exception of the Bombay and Rajasthan Corporations, no other Corporation has availed of this facility so far. In the case of these corporations, borrowings from the Reserve Bank at the end of March 1959 were nil.

Management

Before proceeding to deal with the loan operations of the Corporations, it may be appropriate, at this stage, to indicate the salient features of the Act in regard to the management of the Corporations. The main objective of the statutory provisions is to ensure effective Government control of the Corporations. The management of each Corporation is entrusted to a board of ten directors. The State Government concerned appoints the managing director (perhaps in consultation with the Reserve Bank) and nominates three other directors one of whom is the Chairman. The Reserve Bank and the Industrial Finance Corporation of India nominate one director each. The scheduled banks, insurance companies, investment trusts, co-operative banks and other financial institutions elect three directors, one of whom represents the scheduled banks, another the co-operative banks and the third represents the remaining financial institutions. The other shareholders are represented by one director elected from among themselves. The majority of the directors are thus nominated by the Government and quasi-Government institutions. Furthermore, the board is guided by instructions on matters of policy given by the State Government in consultation with the Reserve Bank.

The types of assistance which the Corporations may render, laid down in the Act, follow closely those of the Industrial Finance Corporation of India. Thus, the State Financial Corporations may (a) grant loans or advances to, or subscribe to the debentures of industrial concerns repayable within a period of 20 years; (b) guarantee loans raised in the market by industrial concerns and repayable within 20 years; (c) underwrite the issue of stocks, shares, bonds or debentures by industrial concerns, subject to the condition that any part of the issue taken up in pursuance of the

underwriting agreement is disposed of within seven years. The Corporations are *prohibited* from subscribing directly to the shares or stocks of any company, because their object is to assist industrial concerns in obtaining loan capital and not to act as holding companies or investment trusts.

The financial assistance rendered by the Corporations so far has been almost entirely through the grant of loans and advances. Their subscription to debentures has been insignificant. Only the Andhra Pradesh and Bombay Corporations have subscribed Rs. 10 lakhs and Rs. 3.75 lakhs, respectively, to the debentures of industrial concerns. The Corporations have not so far underwritten any issue or guaranteed any loan. The subject of the Corporations' engaging in underwriting activity and equity participation was considered at a recent conference of the representatives of the State Financial Corporations and it was felt that the issue was in no sense urgent and that it was not desirable for the Corporations to enter this field of business at the present stage of their development.

There has been a more or less steady increase in loans and advances sanctioned and disbursed.

TABLE 42

LOAN TRANSACTIONS OF STATE FINANCIAL CORPORATIONS

(Rs. crores)

Year	No. of Corporations	Loans sanctioned during the year	Loans disbursed during the year	Loans outstanding at the end of the year*
1953-54	2	0.7	0.3	1.0
1954-55	8	2.1	1.3	2.3
1955-56	12	4.1	1.9	4.0
1956-57	11	4.4	2.9	6.4
1957-58	12	4.8	3.7	9.4
1958-59	12	5.0	3.3	11.4
Total 1953-54 to 1958-59		21.1	13.4	

* Include outstanding amount of loans disbursed prior to 1953-54 in respect of the Madras Industrial Investment Corporation Ltd.

The spurt in loans sanctioned in 1955-56 is partly attributable to the increase in the number of Corporations in operation in that year, which itself was, in some measure, a result of the accelerated pace of economic development in the economy. The slight decline in loans disbursed in 1958-59 perhaps reflects the decline in demand on account of the import cuts and also perhaps some diversion of demand to the newly set up Refinance Corporation. Loans outstanding at the end of March 1959 amounted to Rs. 11.4 crores. The total number of applications sanctioned was 822, giving an average amount of Rs. 2.6 lakhs per application. The classification of loans, by size, sanctioned by the Bombay, Punjab and U.P. Corporations is given in Table 43. As regards loans to small-scale industries, while the number of loans sanctioned was large at 395, the amount was only Rs. 3.08 crores, the amount disbursed being Rs. 1.98 crores.

A State-wise distribution of the total amount of loans sanctioned upto March 31, 1959 indicates that the largest amount was sanctioned in Madras (Rs. 4.6 crores), followed by Bombay (Rs. 3.8 crores), Punjab (Rs. 2.2 crores) and West Bengal (Rs. 2.1 crores). While comparing the performance of the different Corporations, as measured by the loan amounts sanctioned, it should be remembered that the period over which they have operated varies from two to six years and ten years in the case of the Madras Corporation and that the state of, and the scope for, industrial development varies in the different States. The recipients of financial assistance from the Corporations cover a wide range of industries. Absence of a uniform industrial classification in the data provided by the different Corporations makes it difficult to give a detailed industry-wise breakdown of the aggregate loans and advances of *all* the Corporations taken together. It is, however, clear from available data that, of the total loans sanctioned upto March 31, 1959 by all the Corporations, textile and engineering industries received Rs. 5.49 crores or 26 per cent and Rs. 2.84 crores or 13 per cent, respectively. Sugar industry accounted for Rs. 1.10 crores or 5 per cent., tea for Rs. 95 lakhs or 5 per cent, chemicals for Rs. 72 lakhs or 3 per cent and electricity supply for Rs. 1.33 crores or 6 per cent. The industry-wise breakdown of loans sanctioned by individual Corporations obviously shows variations. Thus, in Madras and Madhya Pra-

TABLE 43

CLASSIFICATION BY SIZE OF LOANS SANCTIONED BY THREE STATE FINANCIAL CORPORATIONS UPTO MARCH 31, 1959.

(Rs. Lakhs)

	Bombay		Punjab		U.P.	
	No.	Amount	No.	Amount	No.	Amount
1. Loans not exceeding Rs. 25,000	6	1.20	35	6.13	12	2.37
2. Exceeding Rs. 25,000 but not exceeding Rs. 50,000	18	6.75	29	11.25	7	3.10
3. ,, Rs. 50,000 but not exceeding Rs. 1 lakh	37	28.29	43	32.90	14	13.20
4. ,, Rs. 1 lakh but not exceeding Rs. 2 lakhs	47	72.95	32	53.55	6	10.00
5. ,, Rs. 2 lakhs but not exceeding Rs. 5 lakhs	50	136.16	20	66.35	10	42.42
6. ,, Rs. 5 lakhs but not exceeding Rs. 10 lakhs	24	138.25	7	49.50	2	20.00
Total	182	383.60	166	219.68	51	91.09

desh, textiles account for the largest share, namely, 54.5 per cent and 66.2 per cent, respectively. On the other hand, in Bombay, West Bengal and Bihar, the engineering industry accounts for the largest share, namely, 28.5 per cent, 25.7 per cent and 36.7 per cent, respectively. In Uttar Pradesh, sugar is the most important item (33.9 per cent) and tea in Kerala (25.1 per cent) and Assam (35.6 per cent). In the case of the Punjab Corporation, the loans are distributed more evenly over a number of industries, the highest percentage for any group being 17.6 only (metal engineering).

Loans given by the Corporations are sufficiently secured, being granted on the first mortgage of the fixed assets in the form of land, buildings and plant and equipment. The amount of the loans is usually about 50 per cent of the net value of the fixed assets offered as security, thus providing a margin of 50 per cent. The Corporations are also empowered to grant loans and advances against the guarantee, as regards repayment of principal and payment of interest, by the State Government or a scheduled bank or a State co-operative bank. Financial assistance has been rendered primarily for block capital requirements of industrial concerns and, only in exceptional cases, for working capital needs. The period of loans granted for block capital requirements appears to be generally for 10-12 years. Loans are granted by the Corporations on the merits of individual industrial concerns, after a scrutiny of the soundness of the proposals and an examination of the development programme put forward by them with the aid of technical advice. For example, the Bombay Corporation maintains a panel of experts for obtaining such technical advice. The Corporations also keep a watch over the progress of the concerns which have availed themselves of loans, through regular inspections by their officials, in addition to obtaining periodical reports from them.

Lending Rates

As regards the rate of interest on loans and advances charged by the Corporations, the most common rate, as at the end of March 1959, was 6½ per cent per annum, with a rebate of ½ per cent for repayment of instalments of principal and payment of interest on due dates. This was the position in respect of five

out of the twelve Corporations, while in case of one Corporation, the rate was $6\frac{1}{2}$ per cent without any provision for rebate. The rate was 7 per cent in the case of Kerala, Assam, Punjab and West Bengal Corporations and 6 per cent in the case of Madhya Pradesh Corporation, there being provision for $\frac{1}{2}$ per cent rebate for prompt repayment of instalments of principal and payment of interest only in the case of the first two Corporations. In the case of the Madras Corporation, the rate (in October 1958 — the latest available) was the highest at $7\frac{1}{2}$ per with $\frac{1}{2}$ per cent rebate for prompt payment of interest and instalment of principal. A few State Governments viz. Assam, Rajasthan and Punjab, remit, either partially or fully, stamp duties in respect of mortgages created in favour of the respective Corporation.

Loans for Working Capital

The question of grant of loans for working capital was considered at the first conference of the representatives of State Financial Corporations and in the light of the discussions, a tentative draft formula was evolved by the Reserve Bank for the guidance of the Corporations. According to this, the State Financial Corporations should provide loans for working capital only in those cases where the industrial concerns are unable to obtain finance from commercial banks or other sources. The formula also specified a number of points on which the State Financial Corporations should fully satisfy themselves before making loans for working capital either by itself or in combination with block capital. Also, where the loan is primarily required for block capital, the element of working capital should not ordinarily exceed 25 per cent of the total amount applied for, while loans given primarily for working capital should not ordinarily exceed five years. A sub-committee appointed to consider this formula and other problems relating to the Corporations examined the main suggestions made by some Corporations for liberalising these provisions but felt that no change in the formula was called for.

Financial Results

The growth in the activities of the Corporations, discussed earlier, has resulted in a steady rise in the total net profits of all the Corportions, from Rs. 7 lakhs in respect of five Corporations in 1953-54 to Rs. 54 lakhs in respect of 12 Corporations in 1957-

58; in 1958-59 it amounted to Rs. 50 lakhs (excluding the Madras Corporation for which the 1958-59 figure is not available). In spite of rising incomes and profits, the balance of profits at the disposal of the State Financial Corporations, after providing for taxation and transfers to reserve funds, has been inadequate for the payment of the minimum dividend guaranteed by the State Governments under the State Financial Corporations Act. All the Corporations with the notable exception of the Madras Corporation were, therefore, compelled to have recourse to subventions from their respective State Governments in order to meet their dividend commitments throughout the six-year period 1953-59, though the magnitude of recourse to such subventions has been declining in the case of some of the Corporations. However, even during 1958-59, three Corporations had to resort to subventions from the State Governments to the extent of over one-half to about seven-eighths of the amount of guaranteed dividend. In 1958-59, total subventions receivable from State Governments by all State Financial Corporations (excluding Madras) amounted to Rs. 20.81 lakhs.

The total assets of all the twelve Corporations amounted to Rs. 23.4 crores at the end of March 1959. Of this, loans and advances outstanding formed 49 per cent (Rs. 11.5 crores), investments in Government securities 12 per cent (Rs. 2.8 crores) and cash in hand and bank balances for 33 per cent (Rs. 7.8 crores). Subscriptions to the debentures of industrial concerns amounted to only Rs. 14 lakhs (Table 44).

Reserve Bank's Role

The State Financial Corporations have close relations with the Reserve Bank of India. Reference has already been made to the association of the Bank with these Corporations in respect of share capital and representation on the board of management. The Bank has one nominee on the Board of Directors of each of the State Financial Corporations who could also function on their respective executive committees. The State Financial Corporations have generally been consulting the Bank in the matter of appointing managing directors and there have been instances of the Bank deputing its own officers to work as managing directors. Apart from the statutory provision which specifies that the Bank should

TABLE 44

LIABILITIES AND ASSETS OF THE STATE FINANCIAL CORPORATIONS AS ON MARCH 31, 1959

(Rs. lakhs)

	Name of the Corporation												
	Madras§	Punjab	Bombay	Kerala	West Bengal	Assam	Uttar Pradesh	Bihar	Rajasthan	Madhya Pradesh	Andhra Pradesh	Orissa	Total
LIABILITIES													
Paid-up Capital	1,32	1,00	2,00	1,00	1,00	1,00	1,00	1,00	1,00	1,00	1,50	50	13,32
Reserves	4	1	4	1	1	1	—	—	—	1	2	—	15
Bonds	1,36	1,02	1,14	55	50	—	55	1,00	—	—	—	—	6,12
Provision for taxation	—	—	—	—	3	—	—	2	—	—	—	1	6
Subventions from State Govt. (on account of guaranteed dividend)	—	8	—	6	8	6	6	3	6	4	10	—	57
Profit & Loss Account	4	4	1	5	2	5	4	1	4	4	6	2	42
Other liabilities	2,18‡	9	4	4‡	—	33	1	2	—	—	6	—	2,78

TABLE 44 (*Contd.*)

	Name of the Corporation												
	Madras§	Punjab	Bombay	Kerala	West Bengal	Assam	Uttar Pradesh	Bihar	Rajasthan	Madhya Pradesh	Andhra Pradesh	Orissa	Total
ASSETS													
Cash in hand and bank balances	1,55	89	1,06†	29	42	62	62	1,09	21	37	26	47	7,84
Investments in Govt. securities ...	36	31	56	11	—	—	26	—	37	22	62	—	2,81
Loans and advances	2,97	90	1,50	1,19	1,12	74	68	89	43	43	62	6	11,54
Deficit on guaranteed dividend account	—	8	—	6	8	6	6	3	6	4	10	—	57
Debentures	—	—	4	—	—	—	—	—	—	—	10	—	14
Other Assets	5	6	7	7	2	3	4	8	3	3	4	—	52
Total liabilities/assets	4,93	2,25	3,23*	1,71	1,64	1,44	1,66	2,09	1,10	1,09	1,74	53	23,43

§ Figures are as on March 27, 1959. ‡ Includes fixed deposits.

* Does not include subventions from State Government in respect of guaranteed dividend/deficit on guaranteed dividend account. †Of this Rs. 6 lakhs are earmarked for the purchase and cancellation of $4\frac{1}{2}$ per cent 1967 Bonds issued by the Corporation.

Source: Annual Reports of State Financial Corporations for 1958-59.

be consulted before the Corporations issue any bonds or debentures for the purpose of increasing their working capital or frame regulations under the State Financial Corporations Act, the Bank's advice and assistance are generally sought by the Corporations on important matters of policy, as for instance, the investment of their funds. The State Financial Corporations Act also provides that the State Governments should consult the Bank in regard to instructions on questions of policy that may be issued by them to the Corporations. The Bank also helps the Corporations in co-ordinating their functions. In this connection, the Bank has been convening annually a conference of the representatives of the State Financial Corporations, the Industrial Finance Corporation of India and other concerned interests so as to facilitate discussions and mutual exchange of views on various important issues of common interest to them. In the course of the discussions at a conference the Corporations had expressed themselves in favour of statutory inspection of the working of the Corporations and their books and accounts by the Bank and agreed that until the Act was amended, such inspections should be on a voluntary basis. The State Financial Corporations Act has since been amended and the Bank is now empowered, with the approval of the Central Government, to conduct inspections of the Corporations. Government has given general approval to annual inspections which are intended to be made a regular feature of the Bank's activities. Such inspections are primarily meant to assist the Corporations in establishing sound practices and traditions, particularly in matters connected with loans and advances.

Problems of Co-ordination

In recent years, the problem of co-ordination of the activities of the various agencies which provide industrial finance has come to the fore. Besides the State Financial Corporations, such agencies include the Industrial Finance Corporation of India, the Central and State Governments, the State Bank of India and other banks. A clear-cut demarcation between the scope of the Industrial Finance Corporation of India and the State Financial Corporations was effected at the first Conference of the representatives of the State Financial Corporations in August 1954, by arranging that the Industrial Finance Corporation of India should entertain loans for amounts in excess of Rs. 10 lakhs and the State

Financial Corporations should entertain loans for amounts upto Rs. 10 lakhs. The increased provision of financial assistance by Government for the small-scale industrial units created a kind of crisis for the Corporations, in that there was likelihood of a very marked decline in their business. Besides, the Government loans were also to be given at rates below those charged by the State Financial Corporations. Hence steps were taken to allay the misgivings of the Corporation. In the first place, the activities of the State Governments and the State Financial Corporations have been demarcated by fixing minimum limits ranging from Rs. 10,000 to Rs. 75,000, for loans by the State Financial Corporations, loans for smaller amounts being provided departmentally by the State Governments.

Secondly, it was suggested at the second Conference of the State Financial Corporations in November 1955 that the Corporations should be empowered to function as agents of Government for scrutinising and sanctioning loan applications received by Government from industrial enterprises, for disbursing the loans and for collecting and remitting the amounts to Government. To enable the Corporations to undertake this function, the State Financial Corporations Act was amended in October 1956, empowering the Corporations to act as agents for the Central or State Governments or the Industrial Finance Corporation of India in respect of loans and advances granted, or debentures subscribed to by them. Such agency arrangements are in operation in the States of Uttar Pradesh, Andhra Pradesh, Bombay and the Punjab.

Some aspects of co-ordination have been discussed in chapter 5 when the question of finance for small-scale industry was referred to. It has been mentioned already, especially in connection with the pilot scheme of the State Bank, that some Corporations use the services of the State Bank for disseminating information about the Corporations, forwarding the applications, disbursing loans, collecting interest and repayments and allied services.

Appraisal

It is extremely difficult to make an appraisal of the working of the State Financial Corporations, for the performance has

varied from Corporation to Corporation. The general impression which the Corporations *as a whole* have created is that they have not so far done well, judging from the rather small level of their outstanding advances. In defence of the Corporations it must be said that since this is a new type of lending in the country, it takes time to get into stride. The fact that these Corporations have to deal with relatively small borrowers makes the job of scrutiny of loan applications much more difficult, since in general the applications are much less satisfactory than in respect of loan applications from large borrowers, especially joint stock companies. Generally speaking, the risk element is much larger in the case of advances to small enterprises, and the Corporations have naturally to proceed with caution. Direct lending by Government to small industries at concessional rates of interest, the provision of hire purchase facilities by the National Small Industries Corporation and the establishment, in June 1958, of the Refinance Corporation are perhaps some of the other factors which explain the rather slow tempo of the operations of the Corporations.

It may be hoped that the management is in the hands of people with energy, enthusiasm, ability and foresight, because in the case of new institutions like the State Financial Corporations, success depends to a considerable extent on the type of personnel that is appointed.

There need be no adverse comment on the fact that the Corporations have had to depend on subventions from Government for paying the guaranteed minimum dividend. In the first place, any company would take some years before it is in a position to pay a dividend. Secondly, the fact that the Corporations have to pay income and super-taxes, in the same way as an ordinary joint stock company, makes it extremely difficult for them to be able to pay a dividend. To pay a dividend of $3\frac{1}{2}$-4 per cent the Corporations must earn a rate of profit of 7-8 per cent. This is obviously very difficult even if their entire resources are fully utilised in the form of loans and advances. It is only when the paid-up capital comes to occupy a relatively small part of total resources that the Corporations would be in a position to pay dividend without any assistance from Government. It has been suggested that these Corporations be either exempted from taxa-

tion or that the two principal shareholders, namely, the Government and the Reserve Bank forego their dividend. Either of these suggestions would mean loss of revenue to Government and there is no reason why the present system should not continue, since in any event the bulk of the dividend goes to the Government sector itself. The present system has this advantage that it indicates in a clear way the magnitude of subvention that is involved for organising these special institutions.

It is also not desirable to raise the present lending rates of the Corporations since they have been specially set up to fill important gaps in the machinery for raising capital and their assistance is supposed to be given primarily to borrowers who have special difficulties in raising capital elsewhere. Nor have some other suggestions that have been made concerning these Corporations much to commend them. For instance, it has been suggested that Government and the Reserve Bank should take over the entire equity capital of the Corporations. When these Corporations were set up, deliberately non-Government institutions such as commercial and co-operative banks and also individuals were associated with the Corporations in order to assist the process of mobilisation of savings and also provide guidance to the Corporations in their day-to-day working. Other suggestions have been that these Corporations be merged into one Corporation or be amalgamated with the Industrial Finance Corporation of India or converted into subsidiaries of the State Bank. These also are devoid of merit and militate against the fundamental objective of setting up of these Corporations. The establishment of State Financial Corporations, in addition to a Corporation at the Centre—IFC—was a deliberate act of policy with the object of serving, in a more effective way than a central organisation can, the needs of the local medium and small-scale industries and to mobilise local resources. The merger of these into one institution either as a separate one or with the IFC or the State Bank would defeat this purpose. It would appear to be premature to disturb the present set-up of the Corporations. There is no doubt that with the stepping up of private investment for a bolder Third Plan, these Corporations would have plenty of scope for expansion, though some special allotment of foreign exchange has to be made for the small-scale units, which would find it difficult to obtain

foreign collaboration. In the meanwhile, all possible steps should be taken to reduce to the minimum direct Government lending to industry and to route such funds through these Corporations. At the same time, the Corporations should take all possible steps to simplify their procedure and relax rigid restrictions, if any, particularly in respect of small-scale units, which have not received much assistance so far from the Corporations. There is undoubtedly multiplicity of institutional arrangements to cater to the needs of medium and small-scale industries, and problems of co-ordination arise, which are referred to again at the end of this chapter.

(c) THE NATIONAL INDUSTRIAL DEVELOPMENT CORPORATION

The National Industrial Development Corporation (NIDC), which is a full-fledged Government institution, was set up by the Government of India in October 1954 for the promotion and development of industries in India. The Corporation is conceived mainly as an instrument of Government for securing a balanced and integrated development of industries in both the public and private sectors, particularly the development of those industries which are necessary to fill up the gaps in the industrial structure. The Corporation is required to plan and formulate projects for setting up new industries or developing new lines of production. It will take up the study and investigation of industrial schemes and in implementing them, the Corporation will try to secure, where possible, the maximum use of industrial equipment, experience and skill available in the country. The Corporation is not conceived to be primarily a financing agency, this form of assistance being confined to a few special industries. It is primarily a development Corporation.

The Corporation was registered as a *private* limited company with an authorised capital of Rs. 1 crore, of which Rs. 10 lakhs have been issued and have been provided entirely by the Government of India. The finances of the Corporation are provided by Government in the form of grants and loans. Thus, the provision made for grants and loans during the year 1958-59 amounted to Rs. 2 crores and Rs. 5 lakhs, respectively. A sum

of Rs. 55 crores was provided for its activities under the Second Five Year Plan, though it is doubtful if this amount will be fully utilised.

The business of the Corporation is managed by a Board of Directors, including both officials and non-officials, all of whom are nominated by the Central Government. The Government may also appoint one or more of the directors to the office of Managing Director or Managing Directors, Manager or Managers. At present, the Corporation is having only one Managing Director.

Review of Activities

The Corporation has, with the help of foreign technical teams, prepared project reports for a number of new industrial units. The projects have been chosen primarily with a view to developing new lines of production in fields where the country is exclusively or mainly dependent upon imports, and relate to (a) manufacture of industrial machinery in the field of heavy engineering and (b) some crucial industrial materials like raw film, aluminium, synthetic rubber and primary intermediates for the drug, dyestuff and plastic industries.

The selected project may be executed by the Corporation or by a subsidiary company, or could also be executed in collaboration with private enterprise. Some of the projects for which the Corporation had undertaken preliminary project studies have now come to the stage of being converted into projects and have been handed over to other companies, which have been set up for this purpose. The projects undertaken include the setting up of heavy foundry forge with Czechoslovak collaboration, and the heavy machine building plant, the mining machinery plant and the optical glass plant to be set up with Russian collaboration. A firm of consultants has also been engaged for preparing project reports for heavy structural works and heavy plate and vessel works. As regards drugs and pharmaceutical industries, a second team of experts from the U.S.S.R. was invited to formulate proposals and they have submitted their report. Necessary action on their recommendations has been initiated. As regards the schemes for the production of aluminium and synthetic rubber, the techni-

cal studies undertaken by the Corporation have reached a stage at which further progress would depend upon the provision for necessary internal resources as well as the availability of foreign exchange, and in both these projects, interest is being shown by the private sector.

The Corporation has also been functioning as an agency of the Government for the grant of loans to any industry which the Government may desire to assist. Initially the scheme covered loans for the modernisation and rehabilitation of the jute and cotton textile industries, but later it was decided to include under this scheme loans to units manufacturing machine tools. The Corporation has set up three Advisory Committees in Calcutta, Bombay and New Delhi for the scrutiny of applications from jute mills, cotton textile mills and machine tool units, respectively. Upto June 30, 1958, the Corporation had received applications for loans from jute mills for Rs. 8.41 crores, of which Rs. 3.38 crores were sanctioned. Applications for loans from cotton mills aggregated Rs. 27.43 crores, of which Rs. 3.05 crores were sanctioned. Upto March 1959, a sum of Rs. 3.25 crores had been drawn by the Corporation from Government and loaned to various units. The loans given by the Corporation are repayable in not more than 15 equal annual instalments, the first such instalment being payable latest by 18 months from the date on which the loan was drawn. Interest will be charged at 7½ per cent per annum, but the Corporation may accept interest at 5 per cent, if instalments of principal and interest are paid by the due dates. With a view to speeding up the pace of modernisation of jute and cotton textile mills, the Corporation introduced in June 1959 a new scheme of financial assistance, through short-term aid, for installation of new machinery and for replacing old and worn out machinery. Under this scheme, the Corporation will make the machinery available to the mill company as under; the mill company should deposit in advance 25 per cent of the cost of the machinery and furnish a guarantee, from their managing agents or from two of their directors, for the due performance of the contract. Where such a guarantee is not provided, the advance deposit should be 40 per cent of the cost of the machinery. Sums advanced by the Corporation are required to

be repaid in 5 equal annual instalments together with interest at 6 per cent per annum on balance outstanding, the first instalment falling due one year from the date of the advance made.

Mention may also be made of the setting up in September 1959 by the Corporation of a Working Group to suggest measures for an early and thorough modernisation of the cotton textile industry in India. The Working Group will examine the extent of finances necessary, the portion of foreign exchange required, the amount forthcoming from the industry itself and how the balance of the needs may be met from public or private financing agencies. The question of increasing the resources of public financing agencies like the NIDC will also be considered.

(d) THE INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA

The establishment of the Industrial Credit and Investment Corporation of India (ICICI), which came into being in January 1955 and which commenced business in March of that year, is a landmark in the field of special financial institutions in India. It differs from the other Corporations discussed so far in this chapter in a number of respects — ownership, management and lending operations, which are characterised by flexibility. The outstanding contribution of this Corporation is the impetus it has given to underwriting of securities. Except for the nomination of a Government director on the Board, the Corporation is free from any sort of Government control, unlike the other Corporations. On the other hand, foreign banking, industrial and insurance interests and the World Bank have contributed to its resources. The foreign banks etc. are represented on its Board of Directors, while the World Bank seems to exercise some influence on its working. Recently a World Bank expert on finance and development corporations spent an year at the ICICI to help it to improve its working.

The origin of the Corporation is stated to be as under. "Towards the end of 1953, discussions took place between representatives of the Government of India, the Foreign Operations Administration of the U.S. Government and the International Bank for Reconstruction and Development about the possibility of establishing in India a privately owned investment corporation

for the purpose of encouraging the growth of private industry. After negotiations extending throughout 1954 in which a Steering Committee consisting of five prominent Indian business men (who subsequently became Directors of ICICI) acted in consultation with the International Bank for Reconstruction and Development, the Commonwealth Development Finance Co. Ltd. and others, the ICICI came into being on the 5th January, 1955."* Earlier, the Industrial Finance Corporation of India was negotiating for a loan from the World Bank, but in the meanwhile the Corporation's affairs came to be enquired into by the Sucheta Kripalani Committee and presumably on this account the application was withdrawn. At the same time, arrangements were set afoot to start a new institution, which would among other things seek World Bank assistance.

Objects

The Corporation is a public limited company registered under the Indian Companies Act. Its object is to assist industrial development in the private sector. Its operations are designed to be flexible; in general, the Corporation will (i) assist in the creation, expansion and modernisation of private enterprises, (ii) encourage and promote participation of private capital, both internal and external, in such enterprises, and (iii) encourage and promote private ownership of industrial investment and the expansion of investment markets. The principal types of financial assistance which the Corporation provides are:

(i) Secured loans repayable over periods up to 15 years. Such loans may be secured on debentures in cases where a public issue is practicable; in these cases financial assistance will normally take the form of underwriting.

(ii) Subscription to ordinary or preference capital and underwriting of a public issue or of an offer to existing shareholders.

(iii) Guarantees of rupee payments, required, for instance, in the case of deferred payments for capital equipment.

(iv) Loans in foreign currency towards the cost of imported capital equipment.

* The ICICI: *What it is how it works.*

Besides, the Corporation might furnish managerial, technical and administrative advice and assist in obtaining managerial, technical and administrative services to Indian industry.

Ordinarily, the Corporation will not assist small industries and proprietory and partnership concerns. Although there are no hard and fast limitations, generally the minimum amount of assistance which the Corporation will provide is Rs. 5 lakhs. On the other hand, in cases where the amount required by an applicant is larger than it feels able to provide, the Corporation may try to interest other parties or organisations in order to advise how the total requirements may be covered. Further, the Corporation lends assistance primarily for purposes of fixed capital, but in suitable cases it also considers applications relating to 'additional permanent working capital'.

Resources

The *authorised* capital of the Corporation is Rs. 25 crores, divided into 5 lakh ordinary shares of Rs. 100 each and 20 lakhs unclassified shares of Rs. 100 each.* The issued capital at present is Rs. 5 crores, comprising 5 lakhs ordinary shares of Rs. 100 each issued at par. Of this amount, Rs. 2 crores were taken up by several Indian banks and insurance companies and certain of the directors of the Corporation and their friends and associates, Rs. 1 crore by British Eastern Exchange banks and certain U.K. and other Commonwealth insurance companies and other British companies, including the Commonwealth Development Finance Company, and Rs. 50 lakhs by certain nationals and corporations of the U.S.A. The remaining Rs. 1.5 crores were offered for public subscription in India in February 1955 and this issue was over-subscribed. Thus, the total capital taken up in India amounts to Rs. 3.5 crores. The Corporation now has about 1800 shareholders.

The Government of India has advanced to the Corporation a sum of Rs. 7.5 crores, free of interest, repayable in 15 equal annual instalments after the expiry of 15 years from the date of the advance. A further loan of Rs. 10 crores (at $4\frac{1}{2}$ per cent in-

* The shares of the Corporation are approved investment for the purpose of Section 27A of the Insurance Act, 1938.

terest) was recently announced out of the P.L. 480 counterpart funds; it is repayable over 10 years, beginning in the eleventh year. The World Bank has also made available to the Corporation an initial line of credit in foreign currencies equivalent to $ 10 million, for the purchase of imported material, equipment and services; the interest is $4\frac{5}{8}$ per cent. With increased demands on the Corporation's assistance, the Corporation obtained in July 1959, a further line of credit of $10 million from the World Bank. Thus, at present, the resources of the Corporation total Rs. 32 crores. The Corporation is empowered to borrow from other sources too, provided the amount borrowed and guaranteed by it does not exceed *three times* the aggregate of its unimpaired capital, its surplus and reserves and the outstanding first loan from the Government of India.

Management

The Corporation is managed by a Board of Directors, elected in the usual way, comprising not less than 5 and not more than 15 Directors, excluding the Government Director and debenture director, if any. The Government of India has a right to appoint a Director, so long as any part of its advance to the Corporation is outstanding. Since December 1958, the Chairman has been assigned executive powers, with a regular remuneration. There has throughout been a salaried General Manager. It is learnt that there is no Executive Committee; nor has the Chairman power to sanction loans etc. upto a prescribed limit.

Activities

The activities of the Corporation have shown a more or less steady expansion over the last five years or so. By the end of October 1959, the Corporation had agreed to provide financial assistance amounting to Rs. 20.8 crores to 59 companies (excluding 11 applications for Rs. 2 crores sanctioned since the beginning of 1957, which were subsequently withdrawn, reduced or not proceeded with by the applicant companies), as compared to Rs. 13.4 crores at the end of 1958, Rs. 11.6 crores by the end of 1957 and Rs. 6.0 crores by the end of 1956. Of the total sanctions, as of October 31, 1959, Rs. 10.2 crores were in the form of loans, Rs. 8.6 crores in the form of underwriting of ordinary and preference shares and debentures, while direct subscriptions

to ordinary and preference shares amounted to only Rs. 2.0 crores. So far, the largest amount of assistance, including underwriting, by the Corporation to a single company has been Rs. 1 crore. The smallest aid given by the Corporation is Rs. 3.5 lakhs. Financial assistance provided by the Corporation was thus more or less equally balanced as between loan assistance on the one hand and underwriting operations and investment in shares and debentures on the other. Of the total loans of Rs. 10.2 crores, rupee loans accounted for Rs. 3.5 crores and loans in foreign currencies for the balance of Rs. 6.7 crores. The slow rate of increase in rupee loan assistance relatively to that in foreign currencies has been attributed by the Chairman of the Corporation to the existence in the country of several institutional agencies which specialise in the provision of rupee finance and the Corporation being the only institution in a position to disburse loans in foreign currencies.

As against this slow rate of increase in rupee loans, underwriting operations by the Corporation registered a marked improvement during 1958. The Corporation completed 6 operations for Rs. 2.18 crores as compared to 5 operations for Rs. 93 lakhs during 1957 and the Corporation was called upon to take up Rs. 45 lakhs i.e. 21 per cent of the amount underwritten, as compared to Rs. 58 lakhs or 62 per cent in the previous year.

Since its inception in 1955 upto the end of 1958, the Corporation completed 15* underwriting operations for Rs. 4.88 crores, of which it was called upon to take up Rs. 1.77 crores or 36 per cent, the balance having been subscribed by the public. The Corporation would no doubt have subsequently parted with some of its holdings, in view of the substantial rise in the prices of the securities underwritten. This shows that if carefully managed, underwriting, far from being a risky proposition, could be a source of profit, apart from rolling the funds over quickly. Apart from actual underwriting operations, the Corporation also attaches importance to the laying of sound foundation for future activities in this field, with a view to organising underwriting activities on a large scale. It is the Corporation's endeavour, therefore, to interest institutions and firms of good

* Upto the end of October 1959, the Corporation had completed 19 underwriting operations.

standing to join it as underwriters or sub-underwriters. Through a policy of gradually and prudently selling its investments, mentioned earlier, the Corporation expects to help in the process of broadening the investment market and co-operate in the building up of an active stock market.

Upto the end of 1958, the Corporation disbursed Rs. 6.14 crores.* Commitments outstanding amounted to Rs. 3.99 crores, while 14 applications for over Rs. 5 crores were under examination. Total loans to industrial concerns outstanding at the end of 1958 amounted to Rs. 2.17 crores, of which Rs. 1.95 crores were in Indian currency in respect of 7 companies, and Rs. 22 lakhs in foreign currencies in respect of 3 companies.

The industries benefiting from the Corporation's assistance so far cover a wide range and include paper, chemicals, pharmaceuticals, plastics, sugar, rubber, rayon, cement, electrical and automotive engineering, and shipping. The Corporation had by the end of 1958 investments amounting to Rs. 2.16 crores or over 16 per cent of its total commitments in 7 enterprises of the automobile industry, engaged in the production of vehicles, components and accessories. A feature of the Corporation's assistance has been the attention given to the growth of new enterprises. Thus, out of the 44 companies to which the Corporation had sanctioned assistance till the end of 1958, 18 were new companies.

It was stated in its earlier brochure that ICICI does not quote any standard terms for loans or other financial assistance, each case being considered on merits, but it is now learnt that the Corporation charges a uniform rate of $6\frac{1}{2}$ per cent. on rupee loans and $7\frac{3}{4}$ per cent on foreign exchange loans plus a once and for all fee of $\frac{1}{4}$ per cent. If loans are to be drawn in instalments, a commitment charge at a nominal rate of interest is made on the amount not drawn. The Corporation will not take any direct part in the management of a company which it finances, though in some cases it may insist on the right to appoint a director to represent its interests.

* By the end of October, the disbursements totalled Rs. 8.8 crores, Rs. 4.6 crores in the form of loans and Rs. 4.2 crores in the form of shares and securities.

A problem in regard to some of the investments of the Corporation and in particular those in new projects relates to the market value of these being lower than the book cost. To meet any depreciation that may eventually materialise in this regard and any other capital need, the Corporation set up, in 1957, a new reserve fund, 'Capital Reserve Fund not Available for Dividend', to which were credited proceeds of profits realised on the sale of investments, mainly Government securities, net of tax applicable on such capital gains. With a view to building up adequate reserves to meet possible capital losses in its operations and at the same time ensure reasonable dividends to shareholders the Corporation has, according to its Chairman, represented to Government for tax concession, on the ground that the Corporation does not enjoy the benefits available to industrial enterprises in the way of development rebate, additional depreciation allowance and the like.

The total income of the Corporation rose from Rs. 43 lakhs in 1956 to Rs. 54 lakhs in 1957 and further to Rs. 57 lakhs in 1958. While interest on securities and bank deposits declined from Rs. 44 lakhs in 1957 to Rs. 37 lakhs in 1958, interest and dividends (industrial assistance) more than doubled from Rs. 8 lakhs to Rs. 18 lakhs. After meeting establishment and other expenses (Rs. 6 lakhs) and income-tax (Rs. 26 lakhs), the net profit of the Corporation for 1958 was higher by Rs. 2 lakhs at Rs. 25 lakhs. The Corporation has paid dividend at the rate of $3\frac{1}{2}$ per cent in 1956 and 4 per cent in 1957 and 1958, free of tax; no dividend was paid in the first year of operations, namely, 1955. Unlike in the case of other finance corporations, there is no provision for a minimum dividend; nor is there a ceiling to dividend.

The total assets of the Corporation at the end of 1958 amounted to Rs. 13.65 crores, of which cash and bank balances accounted for Rs. 6.06 crores, investments Rs. 4.99 crores and loans and advances Rs. 2.17 crores (Table 45).

The Corporation's working would appear to be on the whole satisfactory. Its outstanding contribution has been, as already mentioned, to stimulate underwriting. The Corporation, on account of its association with the World Bank and foreign commercial banks and investment banks, is exposed to the fresh

TABLE 45

BALANCE SHEET OF ICICI AS ON 31ST DECEMBER 1955 AND 1958

(Rs. thousands)

LIABILITIES	1955	1958	ASSETS	1955	1958
Share Capital	5,00,00	5,00,00	(A) Investments:		
Reserves & Surplus	12,16	22,97	(i) Government securities	4,47,01	54,56
			(ii) Debentures	50,05	84,96
Advances from Government of India	7,50,00	7,50,00	(B) Assistance to industrial concerns:		
Loan from World Bank	—	22,02	(i) Debentures	—	1,09,13
Current liabilities and provisions	14,92	69,70	(ii) Preference Shares	31,96	82,67
			(iii) Ordinary Shares	34,44	1,67,69
			Loans and Advances:		
			(i) In Indian currency	10,25	1,94,78
			(ii) In Foreign currency	—	22,02
			Prepayments	12	31,06
			Fixed Assets	65	4,85
			Interest accrued on Investments	10,55	7,21
			Cash and bank balances	6,92,06	6,05,76
Total	12,77,08	13,64,69	Total	12,77,08	13,64,69

Source: Annual Reports of the ICICI.

breeze of new ideas and techniques. This also enables the Corporation to get more funds from abroad, especially from the World Bank. This may be contrasted with the difficulties of the Industrial Finance Corporation in getting assistance from the Bank, to which reference was made in the Chairman's speech at the last general meeting of the Corporation.

The spheres of operations of the ICICI and the Industrial Finance Corporation overlap to some extent and the question will naturally occur if at the all-India level there is need for two Corporations. This is an aspect of the general question of co-ordination of the activities of the various special financial institutions, which will be discussed later in the chapter.

(e) REFINANCE CORPORATION FOR INDUSTRY

The latest addition to the institutional machinery for the provision of finance for industry is the Refinance Corporation for Industry, which was established in June 1958. The immediate object of the establishment of this Corporation was the channelling of funds amounting to Rs. 26 crores from the counterpart funds, arising from the import of foodgrains etc. from the United States of America in terms of an Agricultural Commodities Agreement under Public Law 480. One of the terms of the agreement was to the effect that a sum of $55 million (about Rs. 26 crores) should be reserved for relending to private enterprises through established banking facilities. After considering various alternatives it was decided, in consultation with the U.S. Government, to set up a new institution for the purpose. However, as explained by the Chairman of the Corporation, for many years, especially after the submission of the Report of the Committee on Finance for the Private Sector, the question of expanding the role of the banking system in the financing of industry and of providing banks with suitable assistance, for this purpose has been under consideration of the authorities. The offer of assistance from the counterpart funds, therefore, proved a suitable occasion for the reorientation of the role of the banking system in the direction of provision of term finance. The Corporation will provide assistance to *medium-sized* industrial units in the

private sector by providing refinancing facilities to its member banks against *medium-term* loans granted by them to concerns under this category.

Constitution and Capital Structure

The Corporation has been registered as a private limited Company under the Companies Act, 1956. The authorised capital of the Corporation is Rs. 25 crores consisting of 2,500 shares of Rs. 1,00,000 each. The Board of Directors of the Corporation have issued shares of the face value of Rs. 12.50 crores on which 10 per cent has been paid on application and a further 10 per cent on allotment. The Corporation has thus an initial paid-up capital of Rs. 2.50 crores. The present shareholders of the Corporation are the Reserve Bank of India (40), the Life Insurance Corporation (20), the State Bank of India (18) and 14 other scheduled banks, Indian as well as foreign (22), the figures in brackets representing the percentage of the share capital held by each.

The Government of India will make available to the Corporation the amounts (upto a sum of Rs. 26 crores) required by it from time to time in the form of interest-bearing loans and arrange to obtain reimbursement in due course from the counterpart funds. The total funds presently available to the Corporation including its issued capital are Rs. 38.5 crores. In the first year, the Corporation borrowed Rs. 5 crores from Government. Under the agreement, the rate of interest payable by the Corporation on the amounts borrowed from Government will be determined every year by the Government of India in consultation with the Governor of the Reserve Bank of India in his capacity as Chairman of the Corporation. In the first year the Government fixed 1 per cent as the rate at which the Corporation should pay interest on the sum of Rs. 5 crores.

The management of the Corporation vests in a Board of seven Directors with the Governor of the Reserve Bank as Chairman. Three Directors represent the interests of the participating banks (other than the State Bank), while one of the Deputy Governors of the Reserve Bank, the Chairman of the State Bank of India and the Chairman, Life Insurance Corporation constitute the remaining Directors.

Nature of Refinance Facilities

Each of the 15 participating scheduled banks has been allocated a quota from the total funds of Rs. 38.5 crores within which the bank may offer certain types of loans to the Corporation for refinance. These quotas vary from Rs. 1.25 crores to Rs. 3 crores depending upon the size of the bank's deposits in India (except in the case of the State Bank of India which has been allotted a quota of Rs. 5 crores) and will be subject to review periodically.

Loans to be eligible for refinance by the Corporation must be for periods between 3 and 7 years and the amount of the loan to any one party under the scheme should not exceed Rs. 50 lakhs. Loans must be to a medium-sized industry, i.e. a concern whose paid-up capital and reserves (other than reserves for the payment of taxes and normal depreciation reserves) are not less than Rs. 5 lakhs and do not exceed Rs. 2½ crores. The loans given by banks must be for the purpose of increased production in the private sector, primarily in industries included in the Second Five Year Plan and such other Plans as may succeed it.

Under the procedure, as finalised by the Corporation, each member bank has to enter into a principal agreement with it in which the general terms for the provision of refinancing facilities within the overall borrowing limit (quota) allocated to the bank are set out. In addition to this, a supplementary agreement has to be signed each time a loan is availed of by a member bank from the Corporation. As part of the procedure, member banks have been advised that loans granted to industrial units prior to the 5th June, 1958 (on which date the Corporation was registered) would not be eligible for refinancing facilities and also that the Corporation would not refinance a loan unless it is submitted to it before the expiry of 12 months from the date on which the loan was granted by the concerned bank. The period of 12 months would be reckoned as from the date of disbursement of the loan or, in the case of a loan disbursed in instalments, from the date of disbursement of the instalment in respect of which refinancing is required.

The Corporation charges interest at 5 per cent per annum on its loans to member banks. The rate of interest charged by member banks to industrial concerns should be at least $1\frac{1}{2}$ per cent per annum above the rate charged by the Corporation; but it should not be more than the rate usually charged by local financial agencies, such as the Industrial Finance Corporation, Industrial Credit and Investment Corporation of India and State Financial Corporations (the last for loans up to Rs. 10 lakhs). Thus the rate of interest payable by borrowing industrial units is usually $6\frac{1}{2}$ per cent.

Operations

Upto June 30, 1959, the Corporation had received 14 applications for refinance from 5 member banks for a total sum of Rs. 315 lakhs, the industries concerned being ferro-manganese, cotton textiles, cement, pharmaceuticals, pharmaceutical chemicals, acids and fertilisers, automobile ancillaries, electrical manufacturing and engineering. Of these, 13 applications for an amount aggregating Rs. 304 lakhs, representing 98 per cent of the amount applied for (viz. Rs. 309 lakhs) were sanctioned. The remaining application for a sum of Rs. 6 lakhs was under consideration. Out of the sanctioned amount, a sum of Rs. 50 lakhs was disbursed to 2 member banks in respect of applications from the ferro-manganese industry.

These figures may appear to be somewhat disappointing, but two considerations have to be borne in mind. One is that in the beginning essential preliminaries took some time so that effective loan operations did not commence forthwith; the member banks themselves take some time to get used to this new type of business. Secondly, during this period of a little over a year the money market was on the whole easy and the capital market was very active, with the result that resort to the Corporation on any significant scale was not necessary.

The loan of Rs. 5 crores from Government at the nominal rate of 1 per cent and the provision of administrative facilities by the Reserve Bank enabled the Corporation to declare a dividend of 4 per cent tax-free for the period ended December 31, 1958.

In his speech at the first annual general meeting, the Chairman stated that discussions had been initiated between the Corporation and the ICICI for a closer working relationship so that the resources available between the two institutions may be more effectively utilised for the benefit of the country's economy. Discussions had also been initiated with the International Finance Corporation and the Commonwealth Development Finance Company with a view to negotiating, in particular cases, for provision of the necessary foreign exchange for schemes for which the rupee finance, in part or wholly, would be provided by the Refinance Corporation.

(f) NATIONAL SMALL INDUSTRIES CORPORATION

The establishment of the National Small Industries Corporation is yet another important step taken by Government to assist the growth of small-scale industry.*

Although small-scale industries fall within the purview of State Governments, the Central Government has been playing an important role in their development. In this connection, an international team of experts was invited by the Government of India in 1953 to study the problems of small-scale industries and recommend a development programme. Apart from the provision of technical know-how and knowledge of business methods and financial assistance in the form of credit facilities, one of the specific recommendations of the team was to give certain services to small-scale units such as (1) assistance in securing Government contracts, (2) marketing facilities and research and (3) supply of machine tools on easy instalment basis. In pursuance of this recommendation, the Government of India set up in February 1955 the National Small Industries Corporation as a *private* limited company, wholly owned by the Government of India, with an authorised capital of Rs. 10 lakhs, of which Rs. 2 lakhs were paid-up during 1955-56 and Rs. 8 lakhs

* Broadly speaking, a small-scale unit was till recently defined as one employing less than 50 persons working with power or less than 100 persons working without power and having capital assets not exceeding Rs. 5 lakhs. In October 1959 it was stated by the Union Minister for Industry that the restriction regarding the number of employees was being given up. But the figure of Rs. 5 lakhs would include the expenditure on land, machinery and erection charges.

early in 1956-57. The authorised capital was raised to Rs. 50 lakhs in January 1957 by creating 40,000 additional shares of Rs. 100 each, the paid-up capital being raised to Rs. 20 lakhs. The paid-up capital was further increased to Rs. 40 lakhs in 1957-58. It was stated in October 1959 that the authorised capital would be further raised to Rs. 2 crores.

Functions

It should be stated at the outset that the Corporation is not primarily a financing institution, though it does provide capital in kind in required cases. Initially, the objective set before the Corporation was to assist small industries in securing orders from Government. Subsequently, other functions were also assigned to the Corporation and these included (1) development of small industrial units as ancillaries to large ones, (2) marketing assistance through mobile vans, research on marketability of consumer goods, marketing news service and opening of wholesale depots for marketing of stores, (3) supply of machinery under hire purchase scheme and supply of domestic sewing machines also under the same scheme to women, (4) construction and management of two Industrial Estates, one at Okhla and the other at Naini near Allahabad and (5) setting up and running of two prototype production-cum-training centres, one at Delhi and the other at Rajkot. The Corporation is also empowered to underwrite and guarantee loans from banks and similar institutions to small-scale units.

Organisational set-up

The Corporation is managed by a Board of Directors consisting of officials nominated by the Government of India. With a view to making its services available to small-scale industries spread all over the country, the Corporation set up in 1956-57 three regional offices, one each at Bombay, Calcutta and Madras. Subsequently, with a view to co-ordinating the activities of other organisations set up for development of small-scale industries, Government decided that autonomous Corporations on a regional basis should be set up and the Board of Directors of these Corporations should consist of representatives of different organisations set up by Government. Accordingly, the Corpora-

tion set up four subsidiary corporations at Bombay, Calcutta, Delhi and Madras in February-March 1957 and the regional offices were merged with these subsidiary corporations.

The Board of Directors of each of the subsidiary corporations was constituted with the Joint Development Commissioner, Small Scale Industries of the respective regions, Regional Directors of the Small Industries Service Institutes and the Managing Director of the Corporation. The subsidiary corporations have an authorised capital of Rs. 10 lakhs each of which Rs. 2½ lakhs have been paid-up.

Operations

The activities of the Corporation are financed by Government in the form of loans and grants. Among the more important activities, mention may be made of the scheme for supply of machinery to small-scale industries on an easy instalment payment system. Under the scheme, the applicants are required to pay only 20 per cent* of the value of the machines as earnest money for general purpose machines and 33-1/3 per cent for special purpose machines. The balance of the cost of the machines is payable in half-yearly instalments spread over a period not exceeding eight years. In case of machines valued at Rs. 2,000 or below, the amount of earnest money is reduced to half of the above limits. The interest rate charged is 4½ per cent in respect of machines valued upto Rs. 15,000 and 6 per cent for machines costing over Rs. 15,000. These rates are fixed lower at 3½ per cent and 5 per cent, respectively, in case of industrial co-operatives. Since the inception of the scheme in 1956 upto March 1959, the total number of applications accepted by the Corporation numbered 1510 in respect of 5,439 machines valued at Rs. 4.67 crores. Of these, orders were placed for 3,596 machines valued at Rs. 3.24 crores, while 2,234 machines valued at Rs. 1.84 crores were delivered.

As regards other activities, an arrangement has been made with the Directorate General of Supplies and Disposals under which it has agreed to accept tenders from small-scale units not

* Only 5% in case of new units to be established for educated unemployed as well as ventures of technological advance and inventive character.

registered with it as approved suppliers and to waive security deposit from them, provided their competency to execute a contract was certified by the Corporation. During 1958-59, tenders valued at Rs. 1.72 crores were secured by the small units from the D.G.S.&D. and his regional offices.

In order to help small units to market their products wholesale depots for different products have been established at Agra, Aligarh, Calcutta, Bombay and some other centres.

The construction of factory buildings at the industrial estates Okhla and Naini have been completed and the thirty-five factories at Okhla constructed in the estate have been allotted to small-scale units engaged in the manufacture of certain essential commodities. The factory buildings at Naini have also been allotted to small-scale units. The Corporation has also set up a raw material depot for supplying standardised and controlled raw materials to small-scale units at standard prices.

A programme for establishing a number of prototype production and training centres has been drawn up and the Corporation has been entrusted with the responsibility for establishing such centres at Okhla and Rajkot.

Mention has already been made (in chapter 5) of an agreement with the State Bank of India under which small-scale industrial units securing Government and other orders through the agencies of the Corporation could obtain an advance for the full value of raw materials pledged to the Bank, the Corporation guaranteeing the additional finance that the Bank would grant beyond its usual limits against the security of raw material offered. The scheme came into force in January 1959. For each individual limit, the guarantee is limited to Rs. 25,000 while the overall limit of the guarantee is fixed at Rs. 30 lakhs.

(g) CONCLUDING OBSERVATIONS

India has now an adequate network of special institutions for providing medium and long-term finance to industry in the private sector. It may be stated that the period of gestation or teething troubles for these Corporations is over. Rather, the problem is now one of co-ordination of their activities, both to avoid overlapping of operations and to pursue joint ventures, espe-

cially in the field of underwriting. Reference has already been made to the understanding between the IFC and the SFC regarding the respective size of loan applications which each should entertain.

At the all-India level, barring the NIDC, which is not primarily a financing agency, there are three institutions, namely, the IFC, ICICI and the RCI, of which the last deals only with banks directly. The co-ordination between these could take the form of (i) pursuit of common policies and procedures in the grant of assistance, (ii) prevention of over-borrowing by any one borrower by resorting to more than one of these institutions and (iii) collaboration in underwriting and loan operations. Different set-ups and constitutional provisions militate against any substantial measure of uniformity in their working; nor is such uniformity desirable, since one of the objects in setting up several institutions is to achieve a certain measure of diversity of outlook and operations.

The principle (ii) above is very important. Care should be taken to see that the same borrower does not obtain very large assistance in the aggregate from these agencies. Apart from the risk element, such assistance would militate against the fundamental objective of these corporations (perhaps with the exception of the ICICI), which is to provide assistance where borrowers find it difficult to raise funds in the usual way. So no borrower should be permitted to obtain a lot of assistance from the different institutions. Perhaps so far this has not happened to any large extent; probably the Government director would himself keep an eye on this aspect of the matter. All the same, this has to be kept in mind continuously, especially since the tempo of investment activity in the private sector is likely to go up, as part of a 'bolder' Third Plan, and requests for assistance would be numerous. The assistance sought from these institutions should not be large as compared to the resources raised by the promoters themselves.

Collaboration among the Finance Corporations as well as between them and other bodies like the Life Insurance Corporation and commercial banks, in the field of underwriting, will be very helpful. As already mentioned, the ICICI has given much impetus to underwriting operations and the IFC has at last ven-

tured into this legitimate sphere of activity. The IFC may also engage in direct investment in shares as well as seek the right of converting the loans into equity capital. which may later be sold at a profit, to which the Corporation should legitimately look forward to. These should impart flexibility to its operations, which is also to the good; these modes of assistance should assist the Corporation in achieving a quicker turnover of its funds than at present. The State Financial Corporations would naturally find it difficult to enter these fields, but they should make a modest beginning, especially where the quantum of assistance is not too small. Consideration should also be given to collaboration between the SFC and ICICI, the latter providing foreign exchange part of a loan.

There is already a considerable measure of co-ordination and collaboration between the SFC and other agencies providing credit to small-scale industry.

The various Corporations have not so far done much of a job of mobilising resources from the public, other than institutional investors; nor does it appear that there is much scope for this. For one thing, the *maximum* rates of dividends that have been fixed for these Corporations (other than ICICI) are by no means attractive to non-institutional investors, notwithstanding the fact that they carry *minimum* guaranteed dividends. In many cases, the guaranteed dividend is rather low judged by the prevailing pattern of yields. If these are revised and if the maximum is also raised somewhat, there is scope for these Corporations to raise additional equity capital from the public. There is also a case for larger contributions to the resources of these Corporations by the LIC, and this should be forthcoming when these institutions have used up their present resources.

It is of the utmost importance that the major portion of assistance of the institutions should be given to new units and new industries, which are the ones to experience difficulty in raising capital.

These institutions have been so far intended to provide only the marginal requirements of the private sector for term capital. In the three years 1956-59 these Corporations together loaned or provided net assistance of the order of Rs. 32 crores, which,

though in absolute terms not an insignificant sum, forms only about 5 per cent of the estimated gross fixed investment by the organised sector. Whether the share of the assistance provided by the Corporations will grow in the coming years is hard to say. Much depends upon the taxation policies of Government. The magnitude of private sector investment in the Third Plan is likely to be significantly larger than in the Second Plan and if Government takes away a lot more from the private sector in the form of taxation and contractual saving, the private sector would be compelled to seek larger assistance from the Finance Corporations, which means that a part of the resources raised by Government would have to be put back at the disposal of the private sector. Despite occasional evidence to the contrary, there is no reason to fear that Government will take a narrow view of its own requirements rather than a national view of the resources position. Government's approach is likely to continue to be pragmatic.

There cannot be any finality about the institutional arrangements for the provision of finance for industry. These require continuous adaptation to the varying economic circumstances, such as the magnitude of the investment effort, the shifts in the relative share of public and private sectors, the progress of voluntary saving, growth of direct investment as opposed to institutional investment and changes in taxation. However, it would appear that for some years to come there is no need to set up any new financing institution so far as the industrial sector is concerned. Balanced growth of the existing institutions is the thing that needs to be attended to.*

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* Two very good reference books on the subject of finance and development corporations are: (1) *Development Banks* by William Diamond and (2) *Problems and Practices of Development Banks*, by Shirley Bosky, both published by Johns Hopkins Press, for the World Bank.

Chapter 7

GOVERNMENT FINANCE FOR INDUSTRY

General

In India, the provision of finance for industry by Government has been steadily rising in recent years, though in the very nature of things such financing can only be, by and large, marginal. However, in some special cases, for instance, shipping, Government assistance is substantial. It is necessary to emphasise that Government financial assistance to industry is not peculiar to India; it is prevalent in most free enterprise economies. Generally speaking, the assistance is given to industries which are relatively new and which require tremendous capital investment and which in many cases are also of considerable importance for national defence. The aircraft industry and air services come in this category; so also shipping. Industries that are victims of prolonged depression, which may in some cases be due to severe competition from abroad, may also receive special financial aid, especially for the purpose of rationalisation. Besides, it is customary to give special financial assistance to small-scale industries, which, everywhere have difficulties in raising capital.

These are also the principal considerations in respect of provision of Government finance for industry in India. In underdeveloped countries, such financing is of considerable necessity, at least in the early stages of industrialisation. Generally speaking, investors have a marked preference for Government securities. Also, with a view to safeguarding public funds in fiduciary institutions such as insurance companies, statutory requirements are in force, as already described for India in Chapter 2, requiring investment of funds largely in Government and quasi-Government securities. Further, on account of the small per capita incomes, mobilisation of saving becomes difficult in a voluntary way and so taxation has to be resorted to

as a method of mobilisation of saving. The proceeds might go to provide the finance for Government investment or might be employed for providing funds for investment in the private sector. In India, since Government itself has undertaken a substantial measure of investment activity, the provision of financial assistance to private sector can only be of small dimensions. This is not to say, however, that Government could afford to be indifferent to the financial requirements of the private sector. In both a full-fledged planned economy and a 'mixed' economy, Government has a responsibility to see that taxation and Government borrowing policies are such as to leave reasonable volume of resources for the private sector investment, which itself would be broadly regulated by Government. Although the magnitude of Government financing, both direct and indirect, through the various special financial institutions, has been rising in recent years only, provision for Government assistance has been in vogue for a few decades, in terms of what are known as State Aid to Industries Acts/Rules, which have been in force in many of the Indian States.

In general, the State Aid to Industries Acts/Rules provide for assistance to new or nascent industries, for industries to be newly established in an area where such industries are undeveloped, or cottage industries including those which need revival or development. The assistance to be given by the State Government may take the form of loans, guarantee of loans raised from banks, grant of raw material and land at favourable rates, supply of machinery, guarantee of minimum return on shares and debentures, etc. The period of loans generally varies from 10 to 20 years.

Till recently, the amount of assistance given in terms of the above Acts/Rules was very small, though in the former princely States of Hyderabad and Mysore, the State Government's assistance to industry was rather significant. Thus, at the end of March 1950, the amount of loans outstanding in 8 of the States was only Rs. 3.82 crores. Since 1951 such assistance has been growing with the inauguration of the Five Year Plans, though comprehensive data are not available. A part of the

assistance has taken the form of contribution to the capital of the various special Financial Corporations, described in the previous chapter.

Assistance to Small-scale Industries

Assistance to small-scale business units is a significant aspect of State aid to industry. In this financing, the Central Government has been playing an important role. The Central Government does not lend directly to small units but loans are given to State Governments, normally in the ratio of 2 : 1, i.e. twice the contribution made by the States themselves to assist the small-scale industries in their respective States. The State Governments have been endeavouring to channel a part of the assistance through the State Financial Corporations.

In order to facilitate the development of small industries, in 1955 the Central Government liberalised the terms on which financial aid would be given through the State Governments*. It also requested the State Governments to liberalise the terms and conditions under which financial assistance was given to small industries. Some of the important features of the liberalised scheme of financial assistance are as follows:

(a) Loans will be given for working capital as well as for capital expenditure i.e. both for short-term and long-term requirements. While giving loans, preference would be given to 'promotional' type of industries, older types of establishments like rice mills and oil mills being excluded. Handlooms/powerlooms are also excluded as separate funds have been provided for them through the Handloom Board. All other types of small industries — village industries and handicrafts included — are eligible for assistance provided no particular industrial unit has received assistance from the All-India Khadi and Village Industries Board or the Handicrafts Board. The outside limit of loans to bona fide small artisans against personal bond will be Rs. 1,000 and against the surety of one or more persons Rs. 5,000. Furthermore, loans will be given against the security of lands,

* The next few paragraphs are reproduced from a background paper prepared for the recent Hyderabad Seminar on the Financing of Small-scale industries.

buildings, equipment, stock-in-trade and other assets, etc. (including those created out of the loan) to the extent of 75 per cent of their value.

Industrial co-operatives would get 75 per cent of the share capital as a two-year loan. Again, 75 per cent of the working capital and investment necessary for the purchase of land, buildings and equipment for an industrial co-operative would be given by the Central Government as a loan. But in no case would a single party get a loan exceeding Rs. 1 lakh or an industrial co-operative more than Rs. 2 lakhs without the Central Government's prior concurrence.

(b) Loans to State Governments are sanctioned on a 10 year basis and the normal rate of interest is 4 per cent. The State Governments are, however, requested to charge a concessional rate of 3 per cent to individuals and 2½ per cent to industrial co-operatives. The maximum ceilings for loans at concessional rates would be Rs. 50,000 in the case of individuals and Rs. 2 lakhs for industrial co-operatives. Amounts exceeding these limits would be charged at the market rate. The difference between the normal rate charged by the Central Government to the States (i.e. 4 per cent) and the concessional rates to be charged by the States would be made good as a subsidy by the Centre to the States. Though normally loans are disbursed by State Governments under the State Aid to Industries Acts/Rules, the services of other agencies could be utilised by them for that purpose. Where institutional and banking agencies are utilised, an addition to the rate of interest will be necessary to cover their charges. The Central Government has stipulated that the addition should not exceed 2 per cent and that they are prepared to share this with the State Governments.

(c) The Central Government is willing to share losses on loans on an agreed basis. Where the Central Government has to contribute more than 75 per cent it would bear only half of the losses.

(d) The Central Government has also agreed to contribute 50 per cent of the salaries and allowances (excluding travelling

allowance) of all additional staff employed by the State Governments for the purposes of dealing with small industries for three years in the first instance.

(e) Powers to grant loans should be substantially decentralised.

In pursuance of the above scheme, most of the State Governments have also liberalised the terms and conditions on which they would provide financial aid to small-scale industries and industrial co-operative societies. Under the liberalised rules, loans upto Rs. 1,000 are being advanced on personal bonds, upto Rs. 5,000 against one or more personal sureties and above Rs. 5,000 against security, which may include land, buildings, machinery, equipment, stocks and other assets including those created out of the loans, upto 75 per cent of the value of the securities offered. The loans are repayable in easy instalments spread over a period of 10 years. Recommendations regarding rates of interest — $2\frac{1}{2}$ per cent for loans upto Rs. 2 lakhs to industrial co-operative societies and 3 per cent for loans upto Rs. 50,000 to others — have been fully accepted by most of the States. Powers have been also delegated to District Industries Officers or other field officers of similar status to approve loans upto Rs. 2,000. In some States, loan sanctioning powers for various amounts are delegated to different officers.

As already metioned, some of the State Governments have utilised the services of State Financial Corporations and urban co-operative banks for providing loan facilities to small-scale industries. The State Governments of Andhra Pradesh, Bombay, Uttar Pradesh and Punjab have appointed State Financial Corporations as their agents while the Governments of Mysore and Madras have selected urban co-operative banks for the purpose.

Progressively larger amounts are being advanced by the State Governments to augment the resources of small industries. During the three years 1956-59, 12,545 small-scale industrial units and 426 industrial co-operatives were given loans aggregating Rs. 7 crores.

Medium and Large-Scale Industries

In terms of amount, State assistance to relatively large industrial units has been much larger, especially by the Central

Government. In this chapter discussion will be confined only to the direct assistance made available to large-scale industries in the private sector. The assistance channelled through the statutory institutions has already been indicated.

Information regarding the financial assistance by the Governments in the form of grants and loans as well as through equity participation are available in the budget papers. However, not in all cases are the details of the terms of the loans etc. available. On the basis of the available information, total financial assistance to the large scale industries in the private sector during the four years 1956-57 to 1959-60 (that is, including the budget estimate for 1959-60), may be provisionally placed at Rs. 56 crores (Table 46). If the assistance made available for the purpose of housing is included, the magnitude of assistance will be about Rs. 100 crores. Though the direct supply of investible funds by the Government may appear marginal in relation to the total requirements of funds, its overall favourable influence on the supply of capital is by no means insignificant. The details of the loans by the Central and State Governments are discussed below.

Central Government Assistance

The industries to which such assistance is being given relate to the production of iron and steel, explosives for civilian purposes, certain types of dyestuff, etc. The Tata Iron and Steel Company was sanctioned a special repayable advance of Rs. 10 crores to be drawn in instalments. With the drawing of Rs. 81 lakhs in 1957-58, the Company has exhausted the full quota. In 1949-50, the Government sanctioned a loan of Rs. 5 crores to the Indian Iron and Steel Company and the Steel Corporation of Bengal for completing the first phase of their expansion. The two Companies were subsequently amalgamated with effect from January 1, 1953 and came to be known as the Indian Iron and Steel Co. Substantial expansion programme estimated to cost Rs. 35 crores has been undertaken by the Company. The Government has since advanced a further loan of Rs. 2.9 crores. Over and above this, a special repayable loan of Rs. 10.18 crores has also been sanctioned to the company for expansion purposes.

TABLE 46

ASSISTANCE TO PRIVATE INDUSTRIAL UNDERTAKINGS BY CENTRAL AND STATE GOVERNMENTS

(Rs. lakhs)

	1956-57	1957-58	1958-59 (R.E.)	1959-60 (B.E.)	Total from 1956-57 to 1959-60
A *Central Government*					
(1) Investments in shares of private industrial undertakings	51	91	4,51	2,44	8,38
(2) Loans to private industrial undertakings	15,71	9,61	7,24	7,03	39,59
Total	16,22	10,52	11,75	9,47	47,97
B *States* (Excluding Jammu & Kashmir)					
(1) Investments in shares of private industrial undertakings	15	23	1,94	1,84	4,17
(2) Loans to private industrial undertakings	48	1,78	1,05	80	4,10
Total	63	2,01	2,99	2,64	8,27
Grand Total (A and B)	16,85	12,53	14,75	12,11	56,24

Note : (1) *Investments* by Central Government in private undertakings include investments in Indo-Stanvac Petroleum Project, Indian Explosives (Private) Ltd., TELCO, Machinery Manufacturers' Corporation and Oil India Private Ltd.

(2) Loans by Central Government include loans to Indian Iron and Steel Co. and Tata Iron and Steel Co. Ltd., Atul Products Ltd., Machinery Manufacturers' Corporation and Private Shipping Companies for Coastal and Overseas Trade.

The loans given to the two steel companies are from the Iron and Steel Equalisation Fund and (except the loan of Rs. 7.9 crores to the Indian Iron and Steel Co.) were interest-free upto June 30, 1958. Under the terms of the agreements with the companies, the Government was to decide, on the advice of the Tariff Commission, the rate of interest that should be charged from July 1, 1958 and the repayment schedule. The matter was accordingly referred to the Tariff Commission, which has fixed the rate at 5 per cent.

Atul Products Ltd., Ahmedabad, which manufactures Azo and nappthol dyes, has also been sanctioned a loan of Rs. 3 crores. The first instalment of Rs. 75 lakhs was paid to the Company on March 31, 1955; so far, the Company has drawn Rs. 1.36 crores. The Government has also made a loan of Rs. 5 lakhs to Machinery Manufacturers' Corporation.

The Government is holding Rs. 2 crores of the 5 per cent preference shares of the Tata Locomotive Company. There is not much of participation in the share capital by the Central Government. The Government has also bought 4½ per cent tax-free special cumulative preference shares of the Machinery Manufacturers' Corporation, the subscribed amount being Rs. 25 lakhs. The Government is participating on a large scale in the capital of the Assam Oil Company, a wholly owned subsidiary of the Burmah Oil Company, which was granted certain prospecting licences for petroleum in Assam, subject inter alia to the condition that it would associate Indian capital to form a Rupee Company for production of crude oil from these areas. Thus, under the agreement between the Government of India and Messrs. Burmah Oil Co./Assam Oil Co., Government will subscribe to the equity capital in the joint venture entitled Oil India Private Ltd., to the extent of 33-1/3 per cent. The Company will have an authorised capital of Rs. 50 crores and the first issue of the capital will be of Rs. 12 crores, one-third of which will be subscribed by the Government of India. The Government, in addition, will meet one-third of the expenditure on laying the pipelines. The budget has made provision for Rs. 4 crores in 1958-59 (R.E.) and Rs. 2 crores in 1959-60 (B.E.) in this behalf.

The Government is also to contribute 25 per cent of the expenditure of Indo-Stanvac Petroleum Project — a joint venture of the Government of India and the Standard Vacuum Oil Co. The contribution of the Government upto 1959-50 will be Rs. 2.41 crores in this behalf.

Sometime back, for the manufacture of explosives, the Government entered into an agreement with Imperial Chemical Industries Ltd., for setting up a new Company to be called "Indian Explosives Ltd.", with Government participation. Out of an authorised capital of Rs. 4 crores, the initial issue is for Rs. 2 crores, the Government's subscription being 20 per cent (Rs. 40 lakhs)

Of all categories, shipping companies have perhaps received the largest amount of direct loan assistance from the Central Government. Early in 1951, the Government devised a scheme for loan assistance to the shipping companies on reasonable terms to enable them to acquire ships for coastal and overseas trade. During the First Plan, accordingly, Government sanctioned Rs. 24 crores for this purpose. A sum of Rs. 37 crores (exclusive of a carry over of Rs. 8 crores from the First Five Year Plan) was provided in the Second Plan for the development of shipping in the public and private sectors, though it would appear that this figure may well be exceeded. Of this amount, Rs. 17 crores have been earmarked for grant of loans to private shipping companies. Out of this, loans to the extent of Rs. 14.08 crores have already been granted for ordering ships both for coastal and overseas trades. These loans are made at concessional rates of interest; till recently the rate was 2½ per cent for purchase of ships for *overseas* run and 4 per cent for purchase of ships for *coastal* traffic. It is learnt that recently the rate was made uniform at 3 per cent. The loan is given upto 85-90 per cent of the value of the ship. . .

It may be noted that the Merchant Shipping Act, 1958, provides for the establishment of a Shipping Development Fund on a statutory basis to provide a permanent source of rupee finance mainly for giving loans to the Indian shipping companies. The Fund is to be built up from loans and grants from the Central Government. A provision of Rs. 4.8 crores as loan to

the private shipping companies and Rs. 5.0 crores as loan to the Shipping Development Fund was included in the budget estimates for 1959-60.

Assistance by State Governments

As already mentioned, the assistance to industries by State Governments is given direct from the State funds under the various State Aid to Industries Acts and the Rules framed by the Governments. Assistance to small scale industries has been discussed earlier. In this chapter, we are considering only the direct assistance given to medium and large-scale undertakings in the private sector. Under the existing programmes of the planned development of the economy, the State Governments have comparatively limited scope for making any large-scale financial assistance to the private industries. By and large, there seems to be a growing tendency to leave the field of major industrial projects in the hands of the Central Government. From the information available in the budget papers, total assistance in the form of direct loans and equity participation made available to the major private undertakings by the State Governments (excluding Jammu and Kashmir) will be of the order of Rs. 8 crores during the four years 1956-57 to 1959-60, direct loans Rs. 4 crores and equity participation another Rs. 4 crores. The details of the terms of loan assistance are not available.

We have so far discussed Government assistance to industry. There are other spheres too in which Government assists investment in the private sector. Apart from agriculture, which is discussed separately, urban housing is an important field where Government financial assistance is steadily growing, though it is still small as compared to private investment. In India, there are no institutions like the building societies of the U.K. to cater to the financial requirements of construction activity, which is predominantly financed by non-institutional agencies. But in recent years provision of Government finance for housing activity is rising, and recently the Life Insurance Corporation started giving loans to the State Governments for housing. State assistance is mainly in respect of houses for industrial workers and other low income groups. The assistance in the case of housing for industrial workers takes the form of subsidies as

well as loans, whereas in respect of low income group housing, the assistance is mainly in the form of loans. The assistance is provided mainly by the Union Government and is mostly channelled through the State Governments. Co-operative housing societies receive priority in the matter of such assistance. Disbursement of loan assistance for housing amounted to Rs. 43 crores in the first four years of the Second Plan period. To the extent that housing finance is provided by Government, the pressure of demand for funds on the capital market diminishes.

Government does not appear to have been satisfied with the progress of housing and is keen on expanding considerably construction of houses in the Third Five Year Plan. In this connection an important proposal that is being mooted is the establishment of Housing Finance Corporations, broadly on the lines of the other special financial corporations. In some States there are semi-autonomous housing boards, which are also authorised to borrow, though information is not available if in fact any housing board raised money in this way. But, judging from the experience of the other finance corporations, it is doubtful if the proposed housing finance corporations can mobilise much money from non-institutional investors. There is however no harm in establishing the Corporations, provided there is no tendency for any large-scale dependence on the Reserve Bank for funds. It has been suggested that these Corporations might also undertake guaranteeing or insuring the loans given for housing purposes by other agencies.

Chapter 8

STOCK EXCHANGES

Functions of a Stock Market

The stock market is a very important constituent of the capital market, as briefly explained in Chapter 2. While a well-developed stock market is of assistance primarily to private enterprise, Government, semi-Government and local authorities also benefit, in that it assists them in raising loans. Trading in securities takes place either under the auspices of an organised market, namely, the stock exchange or in the unorganised or the 'over-the-counter' market. The former (i.e. stock exchange) is also known as the 'auction' type of market, since the bids and offers are made in the stock exchange hall, where a large number of members or their representatives congregate for trading. The over-the-counter market is a 'negotiated' market, either because the transactions are necessarily fewer in number as in the case of securities of small companies or because the average value of a transaction is very large, as in the case of Government securities. Ordinarily, the securities of relatively large companies are dealt with on the stock exchange; these are known as 'listed' securities. Trading in Government and semi-Government securities and securities of the numerous relatively small companies takes place in the over-the-counter market. Trading in the over-the-counter market too generally requires the services of stock-brokers; the prospective buyers and sellers rarely come together, and even if they do, there are advantages in putting the transaction through a broker. Under the present law relating to trading in securities, transactions in any security (other than Government and semi-Government securities) which are not *spot* delivery transactions have to be put through either members of recognised stock exchanges or licensed stockbrokers in places where stock exchanges do not exist (see Chapter 2). The licensing arrangements have not yet been put into effect.

So far as relatively large companies are concerned, the securities are generally listed on a stock exchange; if the security is not listed (which may be because the company is unwilling to comply with the listing requirements, which are intended to safeguard the interests of investors) the stock exchange authorities ordinarily prohibit their members from entering into any transactions in that security. This would sooner or later force the concerned company to seek listing of the security. Also, the Government has the power to compel a company to have its securities listed on a stock exchange. Listing is good for the shareholders and it is also good for companies, since larger marketability renders it easier to issue new securities. In the case of very small companies, where shares are closely held in a relatively few hands, transactions are few and far between and listing on a stock exchange is not of much help. Besides, the transactions in these are mostly spot transactions, delivery and payment being completed almost immediately after the contract is made. Therefore, in regard to trading in securities of joint stock companies, the stock exchange is of principal interest.

There are, unfortunately, several misconceptions in the minds of the general public (and occasionally the Government too) not only in India but even in some developed countries, regarding the role of the stock exchanges in a country's economy. A stock exchange is compared to the race course where fortunes are made and lost. In view of the fluctuations, sometimes rather wide, which occur in stock prices, stock exchanges are also regarded as gambling dens and frauds on the genuine investors. Some critics have gone to the extent of suggesting the total abolition of stock exchanges in the country. Such attitude towards the working of the stock exchanges is totally uninformed and altogether erroneous. The various committees that have been appointed, in India and abroad, to inquire into the working of stock exchanges and suggest methods of regulation, have all clearly recognised the indispensability of a stock exchange to the growth of an economy where the private sector predominates or constitutes a significant part of the economy.

Stock exchanges are organised markets for securities just as the commodity exchanges are markets for commodities, and they are subject to the same basic influences of supply and demand.

In the case of an agricultural commodity like wheat or cotton, there are regular supplies every year, the bulk of the supplies being extinguished through consumption. In the case of securities, there is hardly any decline in volume, except to the extent that companies are liquidated. At the same time, there are new issues of securities every year, so that the volume of outstanding securities and the volume of transactions go on rising more or less continuously. The joint stock company form of organisation provides for change of ownership of shares and debentures and so there is need for a market to facilitate purchases and sales. Perhaps, the stock exchanges could be regarded as the only perfect type of organised market because the commodity dealt with on the stock exchanges has negligible carrying cost, is imperishable and is absolutely standardised.

The scope and functions of a well-organised and efficient securities market were admirably summarised in a speech made in November 1955 in the Lok Sabha by the then Finance Minister, Shri C. D. Deshmukh, while introducing the Securities Contracts (Regulation) Bill. He said "The economic services which a well-constituted and efficiently run securities market can render to a country with a large private sector, operating under the normal incentives and impulses of private enterprise are considerable. In the first place, it is only an organised securities market which can provide sufficient marketability and price continuity for shares so necessary for the needs of investors. Secondly, it is only such a market that can provide a reasonable measure of safety and fair dealing in the buying and selling of securities. Thirdly, through the interplay of demand for and supply of securities, a properly organised stock exchange assists in a reasonably correct evaluation of securities in terms of their real worth. Lastly, through such evaluation of securities, the stock exchange helps in the orderly flow of distribution of savings, as between different types of competitive investments."

The first function is also expressed by saying that the stock exchange ensures liquidity of capital. By liquidity we mean the covertibility of a capital asset into cash quickly and with the least possible loss. The same idea is conveyed when it is said that the stock exchange provides a continuous market for securities, a continuous market being one where a security may be

bought or sold at any time during business hours at comparatively small variations from the last quoted price. This is possible because there are always buyers and sellers in the market, either for cash or for forward account. In the absence of an organised market, holders of securities would be hard put to it to find buyers for their securities and often would have to sell them at less than fair prices, with the result that investors would be reluctant to hazard their money in business enterprises. In the same way, prospective investors would find it hard to obtain securities at reasonable prices.

The function of the evaluation of securities through which the stock exchange serves to direct the flow of the community's savings into the most productive forms of enterprise may also be explained briefly. On a stock exchange, because of the forces of competition, the securities are generally evaluated at their true worth, taking into account all the relevant factors, present and prospective, concerning not only the particular enterprise and industry, but also the general economic and financial situation. In the process of determining security prices and yields, the stock exchange also indicates the direction in which the community's savings should be invested, for in a perfect market, price differences between shares represent differences in their profitability and prospects as judged by the collective opinion of numerous competent operators. Thus, the price system established on the stock exchange provides guidance to investors and helps in directing the flow of funds into enterprises which are prosperous and are expected to have a bright future. It is true that with the advent of planned economy, with a large and growing share of public sector as well as Government regulation of private sector investment, the role of the stock exchange in channelising savings is diminished. But its importance in providing liquidity to securities continues undiminished.

Role of Speculation

In fulfilling the above functions, 'speculation' plays a dominant role on the stock exchanges. It is a cardinal feature of the stock market and the whole question of reform of the stock exchanges hangs on our attitude to it. Speculation has been contrasted with 'investment' on the one hand and 'gambling' on the

other. The theoretical difference between speculation and investment is that, while investment "implies purchase of securities for the primary purpose of realising the maximum income consistent with safety, marketability and other factors", speculation means "trading in securities for the primary purpose of realising capital gains — i.e. making a profit by a subsequent purchase or sale at a different price". In practice, however, it is difficult to distinguish between speculation and investment. A transaction may be made as an investment, but later may turn out to be speculation, because of some favourable price trend. Likewise, what was intended as a speculative purchase might be retained as an investment. It is equally difficult to distinguish speculation from gambling. In theory, it is maintained that "whereas gambling consists in placing money on artificially created risks of some fortuitous event, speculation consists of assuming the inevitable economic risks of changes in value." But in practice it is difficult to determine where speculation ends and gambling begins.

Speculation is indeed the distinguishing feature of economic progress. Fifty years ago, for instance, a venture to manufacture aeroplanes, was regarded as a speculation. So are many ventures regarded even today until they become successful. Speculation is not confined to economic life alone. It pervades every sphere, including in particular political life. As the term itself suggests, it is not always that speculation is successful. If there is failure, a price has to be paid, which in the economic sphere means loss of money. Therefore, a natural check to excessive speculation is operative all the time.

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Genuine speculation, which is based on a reasoned forecast of the real value of the investments, performs a very important function. In fact, no stock exchange can operate efficiently, purely on the basis of 'investment' buying and selling, because 'pure' investors in that sense are necessarily relatively few in number. They cannot provide the requisite volume or continuity of business, which alone would enable a large number of buyers and sellers to trade at all times in the exchanges, and to bring about an adjustment of the relative values of the securities in which they trade, in conformity with their real worth. It is the buying and selling of securities on a

large scale on the basis of reasoned forecasts which give the necessary breadth and continuity to the market. In a purely investment market, because of the difficulty of matching purchases and sales, transactions can be made only at the sacrifice of some price, the buyers paying relatively more and the sellers receiving relatively less.

According to the Gorwala Committee, which reviewed the question of statutory regulation of stock exchanges in India in 1951, speculation "has a place in the organised marketing of shares, but it has a strictly limited place for strictly defined categories of persons...... The essence of the regulation of stock exchanges is the control of speculation in stock exchanges and the crux of the control of speculation is its confinement to the right sphere, the right persons and the right type and volume of operations". Most committees and commissions which have given careful thought to the subject of speculation both in India and abroad have arrived at the same conclusion. The Twentieth Century Fund, which carried out in 1934 an exhaustive study of the securities markets in the U.S.A., came to the following conclusion: "The object of our recommendation, therefore, is to increase the effectiveness of security markets in performing their essential functions, first by reducing the volume of speculation, and secondly, by raising the standards of market organization and practice. This, of course, implies recognition of the fact that informed speculation in securities, when adequately restricted and controlled, augments the value of security markets; and conversely, the elimination or even the unduly rigid restriction of speculative activities would lessen their value".

Forward Trading

With a view to facilitating the development of broad and active markets, it is customary to permit on the stock exchange forward trading or what is the same thing, trading for the account. Since there is much misunderstanding of forward trading, its features may be explained in some detail. Forward trading in shares is similar to futures trading on the commodity markets. The essence of this is that transactions entered into during a prescribed period, say a fortnight, are settled at the end of the period. Secondly, there are facilities for carrying over a tran-

saction from one settlement to another settlement; this, in the Indian market parlance, is known as a budla transaction. It is essential to note that carry-over is not compulsory; in fact that would be a wager contract and invalid. The carry-over is effected by squaring up the transaction for the current settlement and *simultaneously* entering into a new transaction for the next settlement. Thus, a person who has bought 10 shares of Tata Steel, which is a 'forward' scrip, has three choices before him. He may take delivery for the current settlement or sell them before settlement and thus square up his position or carry-over the purchase to the next settlement. The carry-over is done through separate but simultaneous transactions, namely, sale for the current settlement and purchase for the next settlement. The operator has to pay a price for the facility of carrying over the transaction, which in effect amounts to borrowing money. The carry-over charge or the *budla* rate is normally determined by the prevailing short-term rate of interest, besides including a small insurance premium. Thus, if the price of the share is Rs. 150, the interest rate 6 per cent and the period of the next settlement 15 days, the *budla,* on the basis of pure interest, is 38 nP. If the carry-over is large, the *budla* could even be 50 nP. This means that if the share is sold for the current account for Rs. 150, it is simultaneously bought back for the next settlement at Rs. 150.50. Corresponding to the buyer who wants to carry-over his purchase, there must be a person willing to carry-over his sale transaction from the current to the next settlement. He may be a speculator who has sold for the current settlement and is seeking to carry-over his sale to the next settlement. Or, he may be a financier, who is willing to invest his funds temporarily; he buys for the current settlement and simultaneously sells for the next settlement. The person who is carrying over a sale transaction is in effect loaning money and so he receives a payment, that is, the difference between the purchase and sale price (i.e. the 50 nP. in the above example). Also, the *budla* transaction is in effect advancing money without margin; partly for this reason the return on a *budla* transaction is slightly higher than the usual short-term rate of interest, i.e. it includes a risk premium.

It will thus be seen that forward trading in practice means that people may buy shares which they may not take delivery of and for which they need not make immediate payment or sell shares which they do not possess or which they have no intention of delivering. Consequently, the volume of transactions will be substantially larger than in the case of ready or spot business and the extent of speculation will also be considerably larger. Thus, forward trading makes for a much more competitive market, which can discount the various influences on the side of supply and demand. It should also contribute to comparative price stability, as purchases and sales are done ahead of what would ordinarily be done in a purely spot market. However, there are also chances of speculation turning out to be excessive. That is why, some care is taken by the stock exchange authorities in the selection of scrips in which forward trading is permitted; in particular, the scrips must be such that they are broadly held, thus affording little scope for corners and other manipulations. Except in the Bombay Stock Exchange, where there is a long tradition of forward trading and the number of scrips is large, namely 66, in the others the number of forward scrips is small, namely, 14 in Ahmedabad, 13 in Calcutta, 12 in Madras and 4 in New Delhi. Further, generally forward trading is subject to payment of margin money or deposit, with a view to preventing over-trading.

(2) Margin Rates:

In foreign countries, with the exception of the London Stock Exchange, forward trading does not appear to exist in theory. In the New York Stock Exchange, for instance, a transaction has to be completed on the third day; a transaction (say purchase) cannot be offset by an opposite transaction (i.e. sale) entered into subsequently. But, in practice, forward trading can take place because of the facilities for borrowing money as well as shares. That the so-called cash trading may lead to large-scale speculation and that forward trading need not necessarily result in undue speculation is amply illustrated by the experience of the U.S.A. and India in the last two years. Wall Street has boomed with rocket-like speed, in spite of the most stringent margin restrictions, whereas in India the boom has been of much smaller dimensions.

Blank Transfers

While on the subject of speculation and forward trading, some observations may be made on the subject of 'blank transfers' (to which a brief reference was also made in Chapter 2), since it has figured prominently in discussions on the regulation of stock exchanges in India. It was explained that an important feature of forward trading is the carry-over of transactions from one settlement to another. This involves temporary purchase and sale of securities. If every time the purchaser is to have the share registered in his name in the books of the company, forward trading becomes extremely difficult, because of the cost of registration (mostly the stamp duty, which till a few years back varied from one state to another, from 0.75 per cent to 1.5 per cent) and the delay of the registration process, lasting on an average several weeks in India. In the circumstances, the practice developed in India of the transfer deed remaining blank, that is, the name of the buyer being left blank. This means that a person who buys a security *temporarily* as part of *budla* or carry-over operation, need not take the trouble and expense of having it registered in his name in the books of the company. The transfer deed which he receives along with the share certificate is kept by him without entering his name and when he sells it at the next settlement he passes it on to the buyer, who, if he is an investor will put his name and send it to the company for registration.

The question of blank transfers has been examined by several committees. The Atlay Committee, which reported in 1924, recommended the total abolition of blank transfers and a steep reduction in the stamp duty on transfers. The Morison Committee, which examined the question in 1937, went a step further and recommended that blank transfers should be made a "bad delivery" independently of any action Government might or might not take in respect of the stamp duty. The opinion of the Gorwala Committee (1951) was divided on the subject; a section of the Committee held that such transfers ought to be permitted to continue; another favoured restriction of their life to six months through the *bye-laws* of the exchange; yet another section was of the view that blank transfers should be given only six months' validity under legislative sanction. What

was finally done was to empower the stock exchanges to make bye-laws for the regulation or prohibition of blank transfers.

The case for restriction or abolition of blank transfers is based on certain evil practices facilitated by the use of blank transfers. Blank transfers enable the evasion of stamp duty and are helpful in enabling the evasion of income-tax. They facilitate the manoeuvring of managerial control over companies by concealing the identity of the real holder. Because of blank transfers, the registers of companies are rendered incomplete, inaccurate and misleading. In the case of partly-paid shares, the seller's liability for uncalled capital still remains in the books of the company long after he has sold the shares. Theoretically, blank transfers are irregular and there is need to discourage their use.

As against this, it is argued that blank transfers are an integral part of the stock exchange mechanism and their abolition or restriction would restrict the volume of transactions and hence the liquidity of the market. But for the prevalence of blank transfers, *budla* or contango business would be seriously hampered; thus, if forward trading and carry-over are deemed to be an essential part of the machinery of forward markets, the practice of blank transfers cannot be looked upon with much disfavour. In this context, it needs to be recognised that the question of blank transfers at present is not of the same importance as it was sometime before. The evils which emanated from the practice of blank transfers have now been largely brought under control through the operation of the provisions of the Companies Act and Section 27 of the Securities Contracts (Regulation) Act. With the stricter provisions of the Companies Act regulating the working of joint stock companies, no clandestine control of prosperous industrial concerns is now possible. Further, with the coming into operation of Section 27 of the Securities Contracts (Regulation) Act (to which a reference has already been made in Chapter 2), which gives the person whose name appears on the books of the company the legal right to keep the dividend declared by the company, there is no incentive to keep shares blank beyond the period of a year. In the case of some companies which declare dividends at half-yearly intervals, the currency of blank transfers is reduced to about six

months. The stock exchanges have for many years stipulated that if securities are not registered within a specified period (3-4 weeks) the seller is not responsible for the genuineness of the title of the shares. In effect, therefore, the Joint Select Committee's suggestion (referred to in Chapter 2) to restrict the life of blank transfers to six months has been, to some extent, already implemented. The main incentive for blank transfers, namely, the heavy stamp duties on transfers, has also been considerably mitigated by the reduction, in 1955, of the stamp duty to a uniform level of three-fourths of one per cent of the value of the security throughout the country. These changes have undoubtedly put a check on the use of blank transfers.

Organisation of the Indian Stock Exchanges

We may now pass on to a study of the organisation of stock exchanges in India. At present, there are seven stock exchanges, recognised under the Securities Contracts (Regulation) Act, 1956. The pattern of regulation which the Act incorporates is, as already mentioned, that of 'unitary control', i.e., no business in respect of securities which falls within the regulation could be legally conducted otherwise than through a 'recognised' stock exchange and Government's policy is to recognise only one stock exchange for any particular area. All stock exchanges other than recognised stock exchanges are declared illegal. The stock exchanges which have so far been recognised are noted below, together with their year of establishment: (1) the Bombay Stock Exchange (1875), (2) the Ahmedabad Share and Stock Brokers' Association (1894), (3) the Calcutta Stock Exchange Association (1908), (4) the Madras Stock Exchange Association (1923), (5) the Delhi Stock Exchange Association (1947), (6) the Hyderabad Stock Exchange (1943) and (7) the Share Brokers' Association, Indore (1930). In a few other places, such as Bangalore, there is a fairly large volume of business in securities and perhaps a stock exchange will be formed before long. The Bombay Stock Exchange, which is popularly referred to as *Dalal Street*, has been granted permission on a permanent basis and the remaining exchanges for a period of five years. The rules, regulations and bye-laws of the various stock exchanges, which conform to the draft rules framed under the Act, have been made more or less

uniform. As regards membership, Government have not allowed firms to be members of the recognised stock exchanges in their own right. The main objection to firms being admitted as members is that it would give room for evasion of requirements regarding admission fees, deposits, etc. There is, however, no objection to individual members becoming partners for purposes of trading. In the case of the Calcutta Stock Exchange, which it is customary to refer to as *Lyons Range,* the existing shares were split into smaller units to facilitate partners in a firm to become members in their individual right. Entrance fees, membership deposits etc., which are different for different stock exchanges, were fixed by Government in consultation with the stock exchanges concerned. In Bombay, Ahmedabad and Calcutta, in which places there were more than one stock exchange, the members of such stock exchanges as were not recognised by Government were given the right of admission to the recognised stock exchange on easier terms and conditions. If membership was denied to any member of the non-recognised stock exchanges, despite his satisfying the prescribed terms and conditions, the member was given the right of appeal to Government within a prescribed period and Government's decision on the same was considered final and binding on the recognised stock exchange. The relevant details regarding the type of association, membership fee, annual subscriptions etc. of the recognised stock exchanges are shown in Table 47. It will be noticed that there is a certain amount of diversity in the organisation of Indian stock exchanges. For example, the Bombay and Ahmedabad Stock Exchanges are in the nature of private clubs while most of the other exchanges are companies limited by guarantee or public limited companies incorporated under the Companies Act. In Bombay, the President is a whole-time salaried official, while in the other stock exchanges they are honorary officials.

Some measure of the size and relative importance of the various stock exchanges can be obtained from the data regarding the number of scrips listed, number of shares on the forward list etc., which have been shown in Table 48. No data are available regarding the stock market turnover, the only information published regularly in this respect being the number of shares delivered through the clearing house. As regards the turnover.

TABLE 47

STOCK EXCHANGES IN INDIA —

Item	Bombay	Calcutta	Madras
1. Year of Establishment	1875	1923	1937 — Reorganised in 1958
2. Type of Association	Voluntary non-profit making association not registered under any Act	Public limited company	Company limited by guarantee and registered under the Companies Act, 1956
3. Date of grant of recognition under the Securities Contracts (Regulation) Act, 1956	August 31, 1957 (Permanent)	October 10, 1957 (For 5 years)	October 15, 1957 (For 5 years)
4. No. of members (March 1958)	501	278	15 firms (36 individual members)
5. Entrance fee/ Card value	Card value: Rs. 17,500	Entrance fee: Rs. 10,000 Value of shares: Rs. 6000—7000 per share	Entrance fee: Rs. 2500
6. Membership Deposit	Rs. 20,000	Rs. 20,000	Rs. 5000 per individual member with a minimum of Rs. 10,000 per firm
7. Annual Subscription	Rs. 15 per year	Rs. 48	Rs. 180 per individual member

ORGANISATION

Delhi	Ahmedabad	Hyderabad	Indore
1947	1894	1943	1930
Company incorporated under the Companies Act.	Voluntary association of individuals	Company limited by guarantee	Neither a joint stock company nor a registered body under any Act.
December 9, 1957 (For 5 years)	September 16, 1957 (For 5 years)	September 29, 1958 (For 5 years)	December 24, 1958 (For 5 years)
92	451	57	107
Entrance fee: Rs. 500 Value of shares: Rs. 6000-7000	Entrance fee: Rs. 1601 Value of shares: Rs. 1800	Entrance fee: Rs. 2571	Entrance fee: Rs. 1100
Nil	Rs. 5000	Rs. 3000	Rs. 3000
Nil	Rs. 25	Rs. 64	Rs. 10

TABLE 48

STOCK EXCHANGES IN INDIA — SCRIPS LISTED
(AS OF MARCH 1958)

Item	Bombay	Calcutta	Madras	Ahmedabad	Hyderabad
Ordinary Shares					
1. Number	251	582	234	100	23
2. Paid-up capital (Rs. crores)	246	236	60.8	35.4†	10.8
3. Market value (Rs. crores)	393		90.1		10.5
Preference Shares					
1. Number	95	209	118	62	5
2. Paid-up capital (Rs. crores)	35.6	35.6	10.2	13.1	3.7
3. Market value (Rs. crores)	32.6		9.1		3.3
Debentures					
1. Number	12	57	32	—	—
2. Amount (Rs. crores)	6.3	16.1	14.3	—	—
No. of shares on the forward list*	67 (of which 1 pref. and 1 deferred)	13	12	14	Nil
Clearing House managed by	Bank of India	Allahabad Bank	Bank of India	Central Bank	

† Relates to 82 companies
* Relates to the latest position.

rough estimates, based on collections of stamp duty on transactions, indicate the turnover in the Bombay Stock Exchange to be around Rs. 1,500-2,000 crores per annum at present. In nearly all the exchanges, there is forward business, with fortnightly settlements, the Bombay Stock Exchange having the largest number of scrips on the forward list (66 shares). The Clearing Houses at Bombay and Madras are managed by the Bank of India, the one at Calcutta by the Allahabad Bank and the one at Ahmedabad by the Central Bank; the clearing house of the Delhi Stock Exchange is run departmentally but arrangements are being made for entrusting it to a bank. A perusal of the list of securities quoted reveals the markedly regional character of the exchanges, reflecting the industrial development in their vicinity. Barring the shares of a few leading banks and iron and steel companies which are quoted on almost all the exchanges, cotton textiles and bank shares predominate in Bombay; jute, tea, coal, bank and engineering shares in Calcutta; textiles in Ahmedabad and plantations and textiles at Madras.

As regards membership classes, unlike the London Stock Exchange, there is no official distinction between brokers and jobbers. Under the rules, any member can act as both jobber and broker, though when a member buys or sells for his own account he has to give a different contract note as compared to the one he gives as a broker. No organised market can function without jobbing, which is the readiness to buy and sell all the time. It is the jobbers who help to keep the market active; they stand ready to buy when there is selling and to sell when there is buying inquiry. In the Bombay Stock Exchange, the jobbers are known as *Taravaniwalas*, so called because they take away the cream of business. Incidentally, the Taravaniwalas, unlike the jobbers at the London Stock Exchange, do not quote two prices, one for buying and the other for selling. While jobbers in general do not ordinarily keep an open position overnight, the Taravaniwalas are particularly noted for squaring up their position by the end of the day. Thus, while the Taravaniwalas help to maintain a broad and active market, they may also accentuate fluctuations, but this seems to be an unavoidable price to pay.

The members of the stock exchange require assistance for the purpose of entering into contracts with other members as

well as for getting clientele. For this purpose, members are authorised to employ a fixed number of authorised clerks and remisiers (or sub-brokers). Thus, in the Bombay Stock Exchange, a member is allowed to employ 5 authorised clerks. A remisier could also be employed as an authorised clerk. The stock exchanges maintain a register of authorised clerks and remisiers for the information of all concerned. In the Bombay Stock Exchange, there are about 1200 authorised clerks and about 200 remisiers. The authorised clerks transact business on behalf of their employers with other members or their authorised clerks and the members are liable for all transactions (which in stock exchange parlance are known as *bargains*) entered into in the market by their authorised clerks. These clerks are not authorised to transact any business in their own name. The remisiers bring business to the members from the non-members. Both the authorised clerks and the remisiers get a share, not exceeding 50 per cent, of the brokerage which a member charges to the non-member client. Members of stock exchange also share brokerage when business is done with or through brokers and dealers operating in upcountry places, including members of other stock exchanges.

So, in the trading hall, hundreds of members and authorised clerks gather and transact business during fixed hours, which in the Bombay Stock Exchange are from 12 noon to 2-30 P.M. Everybody is in a hurry and the bids and offers have to be mentioned loudly and in general there is a lot of noise, the intensity of which varies. Some uncomplimentary things have been said about this noise, no doubt out of genuine misunderstanding. The author has visited several stock and commodity exchanges abroad and noise is the characteristic of all the exchanges, though perhaps the Indian exchanges are somewhat more noisy, but this is characteristic of Indians generally and is not peculiar to the stockbrokers. In fact, the amazing thing is that in the midst of what to a layman is utter confusion, thousands of transactions, involving crores of rupees, take place in a very orderly way. There are very few disputes among members regarding the transactions; this is a tribute both to their efficiency and integrity.

A large gathering of members and authorised clerks for trading is the feature of mainly the Bombay and Calcutta stock exchanges. In the other stock exchanges, although there is a trading hall, there is not much of the hectic activity that characterises the Bombay and Calcutta markets. In Madras, for example, the members (or their clerks) sit round a table and the Secretary goes on calling each listed scrip and its previous day's quotation and asks, 'any buyer, any seller'? In due course, when business grows in volume, the other exchanges would no doubt follow the Bombay and Calcutta pattern.

The members of the Indian stock exchanges are, by and large, an intelligent and shrewd lot. Though many of them are not much educated in the conventional sense of the term, they can interpret current economic and non-economic developments, Indian and foreign, fairly intelligently and anticipate the future too. All the same, there is need to prescribe some minimum educational qualification for the entrants to the stock exchange, so that they may be in a position to understand and explain the economic trends, which are of increasing complexity, to the investors. A qualifying test by the stock exchanges would also be helpful. Perhaps, on the average, the brokers at Madras are the most enlightened and best informed. Some of the Indian stock exchange firms, such as Place, Siddons & Gough (Calcutt), Batliwala & Karani (Bombay), Lewis & Jones (Bombay), Kothari & Sons (Madras) and Chitra & Co. (Madras) compare favourably with some of the best firms in foreign countries. The President of the Bombay Stock Exchange (Shri K. R. P. Shroff) is perhaps the senior-most among stock exchange Presidents in the whole world. He is now in his eighties and has been President for over 35 years.

Generally speaking, the Indian stock exchanges, particularly the older and bigger ones, have rendered a distinct economic service to the country by providing liquid and continuous markets to a large and growing volume of securities. They may be said to have contributed in some measure to the growth of the investment habit in the country and to diverting savings from investment in precious metals to that in indusrial and Government securities. Price fluctuations in shares in the post-war years have been, no doubt, widespread, but by and large, the

performance of the Indian stock exchanges compares favourably with that of the foreign stock exchanges, especially if regard is had to the economic and taxation policies of the Government since Independence. It is not sufficiently realised that in the present state of the Indian economy, when changes in economic and fiscal policies are inevitable, fluctuations in share prices are equally inevitable. Surely, these measures affect the growth of companies and prospects of profits, dividends, and what is wrong if share prices reflect the changes in the investment outlook? In other words, to put it bluntly, Government policies themselves are a very big speculative factor in the stock market. This is not to say that Government is consciously trying to stimulate speculation. Far from it. But changes in policies should have their repercussions on share prices and for this the stock exchanges and the operators need not be blamed. In the last three years there have been so many changes in the field of taxation in particular that one should be surprised at the modest degree of speculation we have had. In this connection, reference may be made to the sharp upswing in share prices on Wall Street in recent years, in spite of stringent margin regulations, which resulted in the yield on shares falling below the yield on Government securities; in India, the price rise has been less marked. This was so also in the post-Korean war boom. There have been no serious payments crisis for several years now and even the difficulties arising out of the 1952 crash, which followed the world-wide boom in share and commodity prices, were tided over smoothly.

Till recently, speculative activity was by and large concentrated in a few scrips and was accounted for by a few big operators. Speculation by 'insiders', that is by persons connected with the management, including the managing agents, also seems to have been rather widespread in the case of some scrips. Further, speculation has also been encouraged by activities to gain control over management of companies. The situation is however gradually improving in the above respects. Speculation has tended to diminish as listed scrips have risen in number and manipulations such as corners and bear raids have been rendered difficult. Till some years back, a good part of the speculative activity was concentrated in one scrip, namely, the deferred

share of the Tata Steel Company, but this share has been eliminated, through conversion into ordinary shares, thus spreading out the speculative activity over a larger area. The recent changes in Company Law have rendered it difficult to gain control over management of companies and this has also tended to discourage speculation. The stock market no longer receives its main support from a few rich persons, like the princes and *zamindars*. Relatively smaller investors are coming to the market.

Unlike in countries like the U.S.A. and the U.K., the Indian stock market is not dominated by institutional investors. In those countries life insurance companies, provident and pension funds and investment trusts account for a very substantial share of business; the buying of shares by these institutions is stated to be an important reason for the continuous stock exchange boom in those countries in recent years. In India, as we have already noted, provident fund investments have to be almost wholly in Government and semi-Government securities. There are hardly any private pension funds and investment trusts too have developed very little. The only source of institutional investment, apart from inter-corporate investment by joint stock companies, is the Life Insurance Corporation. The proportion of funds invested in shares and debentures to total assets by the LIC is not much different from that of the life insurance companies as a whole, prior to their nationalisation in January 1956. But the important difference is that whereas formerly the operations of the insurance companies in the stock market were spread over a large number of units, in the case of the LIC they are concentrated in a single institution, which is the largest single holder of securities. Naturally, the buying and selling operations of this institution exert profound influence on the stock market. If the LIC were to start buying any share, there would be a general tendency for others too to buy, not only on the part of speculators (who want to buy ahead of the LIC and thus make a profit by sale to the Corporation) but also on the part of investors, since a purchase by the LIC means that *prima facie* the investment is sound. Likewise, when the LIC sells, there would be a tendency for selling by others too. This means that the LIC has to carry out its operations

adroitly, which on the whole the Corporation seems to be doing nowadays. While the Corporation does not engage in frequent buying and selling operations to take advantage of temporary fluctuations in prices, it does not refrain from 'certain' buying and selling operations when circumstances warrant. Sales by the Corporation when prices have risen sharply would certainly produce a stabilising effect, though in practice it is difficult to say when prices have risen quite high. It might be that even after the Corporation has sold, prices may rise further and there may be risk of criticism that it sold its securities 'cheap', but this cannot be helped. On the whole the Corporation is a net buyer of securities, on account of the continuous increase in its funds. It is likely that the Corporation is acquiring a significant part of its securities through subscription to new issues as well as rights issues.

The stock exchanges themselves have been making an effort to restrain over-trading through a system of margins, which is now in vogue on the Bombay, Calcutta, Ahmedabad and Delhi stock exchanges. The main objective underlying the margin system is to restrict excessive trading by compelling members (and indirectly their clients) to maintain deposits with the stock exchange which are directly related to their volume of outstanding business. In the Bombay market, for instance, the margin system is operative in respect of *budla* transactions only, i.e., transactions which are carried over to the next settlement. There are two types of margins; firstly, there is a margin in respect of two scrips, namely, Tata Steel and Indian Iron, and secondly, there is a margin on the overall value of all purchases and sales carried over in respect of all the forward scrips, including Tata Steel and Indian Iron. Only that margin amount which is greater of the two is payable by members. The first margin is based on the *number* of shares to be *budlied* and not on *value* and becomes payable only when the *number* of shares carried over in each scrip exceeds the free limit. In Tata Steel, the free limit is 4000 for individual members and 5000 for firms comprising two or more partners; the corresponding limits for Indian Iron are 10,000 and 12,000. The margin rate is Rs. 2 per share for Indian Iron and Rs. 10 for Tata Steel; the current (early February 1960) prices of the two scrips are, respectively, about

Rs. 22 and Rs. 150. The margin on the over-all value in respect of all purchases and sales carried over is arrived at on the basis of the making-up price fixed by the exchange. The exemption limit is Rs. 20 lakhs for individuals and Rs. 25 lakhs for firms. On amounts exceeding these free limits, the margin is at the rate of 3 per cent on the amount upto Rs. 40 lakhs and at the rate of 5 per cent on the amount in excess of Rs. 40 lakhs. The margin money is deposited with the clearing house on the comparison day (which is usually on Monday or Tuesday following the budla day on Friday) and is not returnable until the settlement day of the following clearing, i.e., it is retained for about three weeks or so. In addition to the above margins, members of the Bombay Stock Excange are required to submit every day a statement of outstanding business in respect of a few highly speculative scrips and the President of the exchange has a right to call for additional margins from any member if there is a marked increase in his outstanding business or in the alternative the President may ask the member to liquidate a portion of his outstanding business. The Bombay system is prevalent in Ahmedabad too.

The margin system in vogue in the Calcutta Stock Exchange is different from that in operation in Bombay in that the margin is payable on the daily outstanding business in respect of the forward scrips instead of on the amount of *budla* business. In Calcutta, the number of forward scrips is relatively small, namely, thirteen. Members whose total outstanding purchases or sales in the clearing scrips exceed Rs. 5 lakhs have to pay margin at the rate of 5 per cent on the amount upto Rs. 10 lakhs and at 10 per cent on the amount in excess of Rs. 10 lakhs. The Committee of the Stock Exchange is also authorised to call for margins from any member even in respect of business below the free limit of Rs. 5 lakhs. The margin money is refunded on the completion of the clearing. If a margin system is to be effective, proper enforcement is necessary and secondly it has to be flexible, in that the free limits and the percentage of the margin payment have to be varied according to the changing circumstances. Also, at times the margin regulations may have to be extended to ready delivery or cash scrips too. These

are detailed matters which need not be discussed here. A beginning has been made in this technique of restraining over-trading and it may be hoped that as a result of the joint endeavour of the stock exchange authorities and the Government, which has now a responsibility for maintaining reasonable stability of the stock market and has adequate powers for the purpose, the margin system will be continuously adapted to the changing situation.

In India, so far, bank credit does not appear to have played an important part in stock market speculation in general, though occasionally speculation in some individual scrips has perhaps been facilitated by bank credit. Also, at times when large-scale new issues of capital are made, perhaps bank credit is resorted to some extent. Bank financing of *budla* or carry-over transactions are also understood to be of relatively small dimensions. The Reserve Bank of India has powers, under the Banking Companies Act, of restraining bank credit against shares and on a couple of occasions in the past, banks have been warned against advancing money against shares for speculative and cornering activities.

To a not insignificant extent, the stock exchanges in India have also functioned as the watch-dogs of investors' interest. They have done much to raise the standards of company reporting and to build up well-defined practices as regards new capital issues, dividend announcements, closure of transfer books etc. through rigorous listing requirements. Their standards, in some cases, have been more rigorous than those of Company Law. With the spread of education and the growth of interest in economic development under the Five-Year Plans, as also on account of the diminished interest in other types of investment, such as land and houses, there is reason to think that investment in shares is spreading and that more and more saving is finding an outlet in investment in industrial securities. However, much remains to be done in this respect by the stock exchanges themselves. A healthy public interest in the investment in shares can be stimulated by the dissemination of information by the stock exchanges regarding their activities. There is much misunderstanding about the working of a stock exchange and there are many who consider investment in industrial securities as

being too risky and the stock exchange can dispel such apprehensions in the public mind by educating them as regards the exact functions of a stock exchange in the national economy. Some stock exchanges and a few leading brokerage firms bring out year-books and some of the latter also publish regularly highly readable market reviews, but what is being done at present is absolutely inadequate. Even in a country like the U.S.A., several measures are being taken to encourage the growth of public interest in shares. The New York Stock Exchange is issuing a monthly magizine, *The Exchange,* which contains delightful articles of interest to investors in securities. Besides, seminars and lectures are also arranged on stock exchange affairs and the visitors' gallery has been thrown open to the public to stimulate interest in investment in securities. Even in London, the old orthodox view is rapidly giving place to one of enlightened self-interest. The London Stock Exchange is issuing a quarterly magazine and has also opened a visitors' gallery.

There is need for a similar change of attitude on the part of our stock exchanges. The scope for the development of private enterprise in India is wide and in this context there is clearly much that could be done to spread the investment habit in shares. This is a job that can be tackled primarily by the stock exchange rather than by individual members. In fact, the Indian stock exchanges should act in concert. The handling of business of small investors is rather costly but the members have to take a long-term view and play their part in mobilising savings. The Government may also consider whether it cannot give some concession in the stamp duty on transfer of shares in respect of small transactions. Also, there is a case for all assistance being given to the establishment of investment trusts, which enable the funds of the small investors to reach the stock exchange.

Government Securities Market

A brief reference may also be made to the organisation of the Government securities market, which differs in some respects from the share market. There is, by and large, much less speculation in this market than in the share market because there are no uncertainties regarding dividend and many other matters such

as management, additions to capital stock, capitalisation of reserves etc. etc. Further, the investors in Government securities, especially of the Central Government, are predominantly institutions, as already mentioned in Chapter 3. The average holdings and the average value of the transactions are very much larger than in the case of shares; a single transaction could run into several lakhs and even crores of rupees. Some investors like insurance companies rarely sell more than a very small percentage of their holdings. The same is true of provident funds. Commercial banks, on the other hand, engage in considerable buying and selling, depending upon their deposit resources on the one hand and their lending on the other. Normally, in the busy season, lasting from November through April, they sell some of their holdings because the demand for bank credit is large, on account of the movement of crops. On the other hand, from May through October, the funds return to the banks, their deposits and cash resources rise, with the result that there is some purchase of securities.

Yet another feature of the Government securities market is the predominant role of the Reserve Bank of India, which both as banker to Government and bankers' bank has to engage actively in transactions in Government securities, known in central banking parlance as "open market operations". It has, therefore, to stock a fairly large portfolio of Government securities to meet the requirements of the market. The loan operations of Government do not take place frequently in the year, whereas the purchase and sale of securities by investors take place all through the year. Hence, it is customary for the Bank to take up a portion of a new loan at the time of the floatation, for sale during the rest of the year. In a sense this may also be regarded as underwriting of Government bond issues. The open market operations of the Reserve Bank, like those of other central banks, are governed by the twin objectives of maintaining monetary stability and of ensuring the success of Government's borrowing programme. If the Bank wants to restrict the supply of money and the flow of bank credit, it will reduce the quantity of securities it is prepared to buy or even sell securities, which will have the effect of restricting the reserves of banks and of lowering prices of Government bonds, raising their yield.

On the other hand, if the Bank wants to bring about monetary expansion, it will considerably reduce its sales or actively purchase securities and thus create reserves; the Government bond prices would rise. The open market operations of a central bank thus influence the pattern of interest rates on Government securities, and since these rates set the pattern for interest rates in the economy as a whole, their influence is widespread.

Not always are the objectives of the Government and the central bank identical in the matter of open market operations and interest rates policy. Sometimes the Government may want a low interest rate in order to keep down the interest burden on public debt or assist the growth of investment and employment, and this may necessitate purchase of securities by the central bank. On the other hand, in the interest of monetary stability, the central bank may like to pursue a restrictive policy and allow the interest rates to go up. Such conflicts between the Treasury and the central bank are not unusual though they are rarely prolonged, for in the long run there cannot be any conflict between Government and the central bank in the matter of basic objective of economic policy, for which Government has the responsibility; the central bank's role is that of an adviser and perhaps a moderator.

In the buying and selling of Government securities too, stock brokers play a very important role. In view of the fact that transactions in Government securities are of very large magnitude, generally speaking, the bulk of the business is handled by a relatively small number of brokers. Hundreds of small brokers no doubt handle purchase and sale of Government securities but the aggregate of their business is small. The bulk of the business passes through the Reserve Bank's brokers who number about 30, taking all the three important centres, namely, Bombay, Calcutta and Madras. For many years now, the practice has developed for banks, insurance companies and investors like the port trusts to do business, now and then, directly with the Reserve Bank rather than through the brokers, whenever the securities to be sold or bought are of large magnitude, but the Reserve Bank tries to discourage this by charging, in effect, brokerage in such cases. It is advantageous to go

through brokers, as far as possible, since that makes for greater competition, which is good for both the sellers and buyers.

Another distinguishing feature of the Government securities market, in India as everywhere else, is that unlike the market for shares it is not an 'auction' market; it is an over-the-counter market. The average size of the transactions is so large that each purchase and sale has to be negotiated. This is not to say that much competition is not prevalent in the Government securities market. On the contrary, there is keen competition for business among the brokers and jobbers. In the result, very fine quotations are obtained by the sellers and buyers, who are, as already mentioned, mostly institutional investors, who generally do a good job of bargain hunting.

It is true that to the extent that institutional investors are compelled to invest a specified part of their assets in Government securities, the market for these securities is not quite free. Also, as already mentioned, the operations of one institution, namely, the Reserve Bank, dominate the market. In some countries, in particular the U.S.A., the central bank confines its operations mostly to very short-dated Government securities and Treasury bills, with the result that the trading in and prices of relatively long-dated securities are largely left to the free-play of the forces of supply and demand. In India, the Reserve Bank operates in securities of almost all maturities. This is a flexible, and broadly speaking, correct approach. Inevitably, this means that the Reserve Bank exercises some control over long-term interest rates too and there is nothing wrong in this, particularly since the Bank is rather well qualified for taking a reasonably correct view of the pattern of rates that should prevail.

The arrangements for the distribution of new loans by Government are not much different from those of any joint stock company's issue, except that institutional investors, in particular banks, are the principal subscribers to the loans. Stockbrokers are also of assistance in the issue of the loans, though their role is much less significant than in the case of company issues. Also, in the case of Government loans, there is no underwriting, though insofar as the Reserve Bank has the responsibility of making the Government loan issues a

success and tenders its own subscription to the issues, it may be said there is underwriting. It should, however, be noted that while this has always been the position so far as Central Government loans go, in the case of the State Government issues, till some years back, there used to be underwriting. In those days, State Government borrowing was not large and the State Government issues did not have much marketability. But things have since changed a great deal. Borrowing by State Governments is now substantial, for the purpose of the implementation of the Five Year Plans, and the investors are also taking greater interest in these securities. They are very much more marketable than they were about 10 years back. Besides, since the attainment of Independence, the State Governments have also been doing much to mobilise local support for their loans. As regards life insurance funds, whereas formerly the support of the premier life insurance companies for the State issues was uncertain, now the LIC, as a national institution, takes interest in all the State Government issues. In the result, the marketability of the State Government issues has increased considerably. The discontinuance of the floatation of State Government issues and the issue by the Central Government of correspondingly larger amounts out of which the State Governments ought to get a share has been suggested, but rightly the suggestion has not been acted upon except once. There is need to mobilise local support and although institutional investors of all-India type constitute the principal subscribers to State Government issues, the local support is not of insignificant dimensions.

Chapter 9

FINANCE FOR RURAL INVESTMENT

General

The discussion so far has related, by and large, to the *organised* sector of the capital market, especially concerning the provision of finance for industry. There is, as in the case of the Indian money market, a not insignificant *unorganised* sector of the capital market also, which meets the credit requirements of various types of activity, including manufacturing, residential housing and agricultural operations. In the earlier chapters, some reference has been made to the financing of small-scale industry and in particular to the increasing measure of Government assistance in this behalf. In the matter of housing also, Government assistance is growing, though it is still of relatively small dimensions as compared to aggregate investment in housing, which probably accounts for about 30 per cent of the entire private sector investment. The flow of institutional finance for housing, that is, through banks and insurance companies, is also very small though, as mentioned in the earlier chapters, there is likelihood of a significant stepping up of assistance for housing from life insurance funds. A good part of the outlay needed for housing is, therefore, financed by the savings of the owners themselves and, to some extent, through borrowing from other individuals, though data on the magnitude of such borrowing are not available. In India, there are no institutions comparable, for example, to the building societies of the U.K. for the provision of finance for construction activity. Co-operative housing societies have been increasing in number, but their operations are on the whole of small dimensions. As already mentioned, there is a proposal to set up State housing finance corporations to mobilise and channelise savings for building activity; in some of the States housing boards are in existence, these having much in common with housing finance corporations. In

the rest of this chapter, however, the financing of rural investment will be discussed. Since agricultural income constitutes roughly 50 per cent of the national income, it is only proper that the problem of capital formation in agriculture and its financing are dealt with separately in some detail.

Till a few years ago, one of the most important problems concerning the rural sector was the large magnitude of indebtedness of the farmers, particularly since the bulk of it was of an unproductive character. Thanks to the substantial increase in commodity prices during the World War II, the burden of the rural debt diminished considerably. Perhaps the outstanding level of debt also recorded a decline. In the post-war years the burden of past debt no doubt declined further but it is not certain that the outstanding sum witnessed a decline. Besides, the Government has also taken action over the last two decades or so in scaling down outstanding agricultural debt and in regulating interest rates.

Investment in the Rural Sector

In recent years, the need for stepping up rural investment and for ensuring adequate finance for this has received considerable attention as part of planned development. The magnitude of outlay by Government itself is now of fairly large dimensions. In the First Five Year Plan, public sector outlay on agriculture was of the order of Rs. 300 crores and on irrigation something like Rs. 350 crores, together constituting 32 per cent of the total outlay in the public sector. In the Second Plan period, public sector outlay on agriculture is placed at about Rs. 570 crores (including outlay on minor irrigation of Rs. 66 crores) and on irrigation at about Rs. 460 crores, together accounting for about 22 per cent of the total outlay. A substantial part (about 40 per cent) of the agricultural outlay is in the nature of *current* outlay, the rest constituting *investment* outlay.

Comprehensive and continuous data regarding investment in agriculture by the private sector are not available. The most im-

portant source of data is the Report of the All-India Rural Credit Survey conducted by the Reserve Bank of India in the year 1951-52. This survey covered 600 villages selected from 75 districts all over the country. The survey data as well as the all-India estimates for the entire rural sector based on the sample of 600 villages are naturally subject to some limitations. Notwithstanding these, the data are reasonably useful and indicate broadly the pattern of rural investment, savings and indebtedness. As already mentioned, these data are available only for one year, namely, 1951-52. A follow-up survey covering the year 1956-57 has been completed in respect of 11 districts. The report of this survey is not yet available, but a brief reference to it has been made in a paper entitled *Financing of private investment: some preliminary estimates,* submitted by the Department of Statistics and the Division of Development and Planning of the Economic Department of the Reserve Bank of India to the Planning Commission's Panel of Economists in August 1959.

According to the All-India Rural Credit Survey, the gross expenditure on capital investment in agriculture (excluding purchase of land and livestock) amounted to Rs. 300 crores in the year 1951-52; for the same year, gross capital expenditure on rural housing and other non-farm expenditure in the rural sector is placed at Rs. 250 crores and Rs. 100 crores, respectively, making a total of Rs. 650 crores. But these figures include not only depreciation, that is replacement expenditure, but also expenditure on repairs and maintenance. The Rural Credit Survey Committee has made *ad hoc* allowances for the maintenance and repair elements at Rs. 50 crores for investment in agriculture and Rs. 80 crores for rural housing; exclusive of repairs and maintenance, the Committee's estimate of expenditure on agricultural investment and rural housing for the year 1951-52 is thus Rs. 250 crores and Rs. 170 crores, respectively. These are inclusive of expenditure by way of depreciation and replacement; that is to say, these are not in the nature of *net* investment figures. In respect of other non-farm rural expenditure, however, the Committee has not indicated the portion relating

to repairs and maintenance, on account of lack of detailed information regarding the composition of this expenditure.

In the Reserve Bank's paper on private investment, referred to above, rough estimates have been given for investment in agriculture, rural housing and other non-farm rural investment in the First and Second Plan periods, on the assumptions that net investment constituted 50 per cent of gross investment and that the ratio of investment in those sectors to agricultural income for the year 1951-52 remained constant in the remaining years of the First Plan and the whole of the Second Plan. It would appear that the data collected in the follow-up survey for the year 1956-57 broadly confirm the assumption regarding the constancy of the ratio between rural investment and agricultural income. For the year 1951-52, the ratio of net investment in agriculture to agricultural income was 2.5 per cent, the corresponding ratio for rural housing being 1.7 per cent. On this basis, the Reserve Bank's paper has arrived at the figure of net investment in agriculture in the First and Second Plan periods at Rs. 600 crores and Rs. 700 crores, respectively, estimates for investment in rural housing being Rs. 410 crores and Rs. 480 crores. It should be emphasised that these figures relate only to monetised investment. As regards non-farm business investment, the Rural Credit Committee was not sure of the composition of the gross capital expenditure, under this head, of Rs. 100 crores which it estimated. The Reserve Bank paper, referred to above, on the basis of this figure, has ventured into giving an estimate of Rs. 225 crores as the net investment for the whole of the Second Plan period.

Details are also available in the Rural Credit Survey Report regarding the distribution of the gross capital expenditure of Rs. 300 crores for the year 1951-52 among the various items. These are given below.

TABLE 49

DISTRIBUTION OF GROSS RURAL CAPITAL EXPENDITURE

(Rs. Crores)

Item	Cultivators 1	Non-cultivators 2	Total 3	% of each item to total 4
Reclamation of land ...	23.3	0.6	23.9	8.0
Bunding and other land improvements ...	41.4	0.9	42.3	14.1
Digging and repair of wells ...	54.5	1.8	56.3	18.8
Development of other irrigation resources	17.1	0.2	17.3	5.8
Laying of new orchards and plantations	26.0	0.1	26.1	8.7
Purchase of implements, machinery and transport equipment ...	56.5	0.8	57.3	19.1
Construction of farm houses, cattle sheds, etc. ...	25.7	0.3	26.0	8.7
Miscellaneous capital expenditure in agriculture ...	50.1	0.3	50.4	16.8
Total ...	294.6	5.0	299.6	100.0

As may be expected, the major portion of rural investment is financed out of the owned resources of the rural population. The following table gives the proportions of *self-financed* gross capital expenditure in agriculture, rural housing, etc.

TABLE 50

PROPORTION OF SELF-FINANCED RURAL CAPITAL EXPENDITURE

Item	Proportion of expenditure financed by owned resources (per cent)
1. Capital expenditure in agriculture	
(i) Purchase of land	45.9
(ii) Purchase of livestock	42.5
(iii) Other capital expenditure in agriculture	66.5
Total	54.2

TABLE 50 (Contd.)

Item	Proportion of expenditure financed by owned resources (per cent)
2. Capital expenditure in non-farm business	45.2
3. Construction and repairs of residential houses and other buildings	70.7
4. Repayment of old debts	74.5
5. Financial investment expenditure	93.6

So far as agricultural investment goes, owned resources accounted for 54 per cent of investment, if purchase of land and livestock also is taken into account; excluding these, the proportion was higher at 66.5 per cent. Likewise, the share of owned resources in respect of construction and repairs of residential houses was high at 71 per cent. As regards non-farm business, owned resources were relatively small at 45 per cent. This shows that there is not inconsiderable dependence on outside resources in the field of rural investment. Of course, the rural population, like the urban population, requires to borrow money not only for investment purposes but also for current farming operations, even as manufacturing industry requires working capital. Besides, there is also substantial borrowing for non-agricultural purposes, in particular, for current consumption and for ceremonial expenditure. In the Report of the All-India Rural Credit Survey, details are available regarding the purposes for which the rural families borrow. The data are given below.

TABLE 51

PURPOSES OF RURAL BORROWING

Purpose of Borrowing	Borrowings for the Purpose as Percentage of Total Borrowings		
	All-Families	Cultivators	Non-cultivators
1. Capital expenditure on farm	27.8	31.5	6.0
2. Current expenditure on farm	9.3	10.6	1.1
3. Non-farm business expenditure	6.6	4.5	18.5
4. Family expenditure	50.2	46.9	69.9
5. Other expenditure	5.7	6.0	4.4
6. More than one purpose	0.4	0.5	0.1
Total	100.0	100.0	100.0

It will be seen that as regards both cultivators and non-cultivators, family expenditure constitutes the largest item. It should be stated that family expenditure includes construction and repairs of residential houses. The next important item in respect of cultivators is capital expenditure on farm, while in the case of non-cultivators it is non-farm business expenditure.

Sources of Rural Borrowing

We may now turn to the sources of credit in the rural sector. We have again to refer to the data for the year 1951-52 published in the Rural Credit Survey Report, which are presented in Table 52. The data refer to *gross* borrowing during the year 1951-52, which for cultivators aggregated to Rs. 750 crores and for non-cultivators to Rs. 125 crores. For the cultivators, it will be noticed that Government and institutional finance play a very minor role, accounting for 3.3 per cent in the case of Government and 3.1 per cent in the case of co-operatives. The commercial banks provide an insignificant share, namely, 0.9 per cent. The most important source of rural credit is the money-lending class, both agriculturist moneylenders and professional moneylenders, accounting for a total of about 70 per cent. The other important category is relatives, accounting for about 14 per cent of the total borrowing. The relative importance of each credit agency naturally varies from one item of investment expenditure to another. Thus, Government finance was relatively more important in the case of investment or long-term borrowing than in respect of current or short-term borrowing; the opposite was the case in respect of co-operative finance.

As at the end of the year 1951-52, the average *outstanding* indebtedness per rural family was Rs. 283; in the case of cultivators the figure was Rs. 364 and in the case of non-cultivators Rs. 129. Multiplying these figures by the number of cultivator and non-cultivator families, we get the outstanding rural debt at Rs. 1302 crores and Rs. 245 crores, respectively. The pattern of credit agencies in respect of the outstanding rural debt was more or less the same as that of gross borrowings during the year. Moneylenders were the most important source, accounting for 72 per cent of the total debt of cultivator families. Debt owed to Government and co-operatives formed 3.9 per

TABLE 52

SOURCES OF RURAL BORROWING DURING THE YEAR 1951-52

Credit Agency	Cultivators		Non-cultivators		All Families	
	Amount (In crores of rupees)	Percentage to total	Amount (In crores of rupees)	Percentage to total	Amount (In crores of rupees)	Percentage to total
1. Government	24.90	3.3	1.83	1.5	26.73	3.1
2. Co-operatives	23.24	3.1	1.96	1.5	25.20	2.9
3. Relatives	106.53	14.2	19.43	15.5	125.96	14.4
4. Landlords (to tenants)	11.45	1.5	6.13	4.9	17.58	2.0
5. Agriculturist moneylenders	186.30	24.9	31.07	24.8	217.37	24.8
6. Professional moneylenders	336.18	44.8	47.63	38.0	383.81	43.8
7. Traders and commission agents	41.20	5.5	12.38	9.9	53.58	6.1
8. Commercial banks	7.07	0.9	2.53	2.0	9.60	1.1
9. Others	12.68	1.8	2.45	1.9	15.13	1.8
Total	749.55	100.0	125.41	100.0	874.96	100.0

Source: *All-India Rural Credit Survey Report*, Volume I, Part I.

Note: The data relate to *gross* borrowing during the year.

cent and 3.7 per cent, respectively. It should be emphasised that these figures relate to borrowing for all purposes, for agricultural investment, current farming operations as well as for other purposes, including consumption.

Co-operative Finance

The relative unimportance of institutional finance in the rural sector is not difficult to explain if regard is had to the nature of the agricultural economy in India. Indian farming is, by and large, of subsistence variety and even today it is much of a gamble on the monsoon. The average landholding of the farmer is small and uneconomic. The commercial banks, which are run essentially on business principles, cannot in the ordinary course be expected to take much interest in the financing of agriculture, both current operations as well as investment. The co-operative form of organisation which has been in vogue for over 50 years also made comparatively little progress till recently. In fact, the general verdict on the co-operative movement was that it was a failure. The report of the Rural Credit Survey Committee gives an exhaustive and illuminating analysis of the causes of failure of the co-operative system. What is worth mentioning is that the authorities, that is to say, the Government and the the Reserve Bank, came to the conclusion that though the co-operative movement had failed, it must be made to succeed. The Rural Credit Survey Committee made a number of far-reaching recommendations for putting the co-operative system on a sound basis; these recommendations are generally being implemented with promptness, though in the last one year or so progress has probably been slowed down on account of controversy over the questions of the appropriate size of co-operative societies at the village level and the participation of Government in the share capital of village societies. The basic approach of the Rural Credit Survey Committee was the creation of an integrated credit structure based on three fundamental principles, namely, State partnership at different levels, full co-ordination between credit and other economic activities, especially marketing and processing, and administration through adequately trained and efficient personnel responsive to the needs of the rural population. The

Reserve Bank of India has been assigned a crucial role in this scheme of integrated credit. As already mentioned, the Bank has implemented many of the recommendations. In particular, the scale of accommodation given by the Reserve Bank to the co-operative system has risen substantialy in recent years; the outstanding advances rose from something like Rs. 6.5 crores in June 1952 to Rs. 78 crores at the end of 1959.

Land Mortgage Banks

The bulk of assistance provided by the co-operative societies is *short-term* in nature for current agricultural operations and marketing of crops. A small portion is also in the nature of *medium-term* credit for purchase of implements, livestock, etc. Thus, in the year 1957-58, the primary agricultural credit societies loaned Rs. 13.46 crores by way of medium-term credit out of total loans of Rs. 82.59 crores. For the provision of long-term finance for agriculture, special institutions have been set up, namely, the land mortgage banks. These institutions, which are organised on a co-operative basis, provide long-term credit both for purposes of redeeming past debt to moneylenders as well as for agricultural improvement, the latter purpose being now of increasing importance. The loans are given against the mortgage of land, generally not exceeding 50 per cent of the value of the land, subject to stipulated absolute limits, though most of the loans are for amounts less than Rs. 5,000. The period of the loans varies upto 20 years, though latterly, loans are being made for relatively shorter periods. The land mortgage banks obtain resources principally through the issue of debentures which are generally guaranteed by the respective State Governments in respect of payment of interest and the repayment of the principal; they are, therefore, trustee securities. The Reserve Bank regularly subscribes to these debentures, though latterly it has not had to take up more than 5 per cent on an average; it can also lend against these debentures, if they carry the State Government guarantee. The co-operative institutions themselves constitute the largest contributing group, accounting for about 50 per cent in 1957-58. The State Bank of India has also begun to subscribe regularly to the debentures. The land mortgage banks, as will be indicated later when the

statistics of these and co-operative societies are described, have made comparatively little progress. At the end of June 1958, for instance, the outstanding loans made by the land mortgage banks to individuals was of the order of Rs. 20 crores only, which is just a flea-bite as compared to the requirements of the rural sector.

Government Finance

The comparatively small magnitude of Government finance for agriculture is also not difficult to understand, in view of the inflexibility associated with direct lending by Government, the special characteristics of agriculture and finally the comparative lack of interest among the Government as well as the people, until the attainment of Independence, in economic development. Until the advent of the Grow More Food campaign during World War II, loans by State Governments to agriculturists (commonly known as *taccavi* loans) were given chiefly under the Land Improvement Loans Act, 1883, and the Agriculturists' Loans Act, 1884. The rules governing the issue of loans under the two Acts are framed by individual States, and vary to some extent from State to State. Under the Land Improvement Loans Act, loans can be given for effecting any improvement in land, 'improvement' being defined as any work which adds to the letting value of land. The Agriculturists' Loans Act enables Government to give loans for relief of distress, purchase of seed or cattle, or for any other purposes not specified in the Land Improvement Loans Act but connected with agriculture. Under the Grow More Food campaign, financial assistance to State Governments for approved schemes was given by the Government of India in the form of loans and grants. Loans were given for permanent schemes of a remunerative nature like minor irrigation and land improvement works. Subsidies were given for small private irrigation works and such other schemes and for seeds, manure, etc. An important aspect of Government finance in recent years has been that connected with the rehabilitation of displaced persons.

The actual disbursement of funds by Government has been on the whole small. This is partly on account of the usual administrative impediments in the way of disbursement of funds

by Government and partly due to inadequacy of Government resources. There have also been widespread complaints regarding corruption of Government personnel in granting loans. It would also appear that since Government finance is usually advanced on security of immovable property, generally the relatively well-to-do type of farmers are the beneficiaries of loan assistance from Government. Further, much of Government finance is of the distress type, that is, for providing relief in cases of famine, drought etc. During and since the war years, however, the scale of Government assistance has been larger mainly to step up the food output. It should also be mentioned that while on the average Government finance is of small magnitude, in particular areas it is of considerable importance.

Moneylenders

It was mentioned earlier that private financial agencies, in particular moneylenders, both agriculturist and professional, constitute the most important source of rural credit. The operations of moneylenders have been subject to much criticism, the main points of attack being that rates of interest are high and that credit is extended indiscriminately for unproductive purposes. While, undoubtedly, the moneylenders have been guilty of these charges to some extent, it would appear that the critics have been unduly harsh on them. They have failed to appreciate the peculiar characteristics of agriculture and the enormous risks involved in lending to the agricultural classes. As already mentioned, the record of the co-operative system, for all the patronage and supervision of Government and the Reserve Bank, and that of the Government itself as a direct lender, has been very poor. Judged in this context, the record of the private moneylenders comes out in somewhat better shape. The high rates of interest charged by the moneylenders reflect, apart from the risks involved, the inherent shortage of savings in the rural economy. In order to minimise the injurious character of private lending, legislative action has been taken, primarily to regulate the rate of interest. The Usurious Loans Act of 1918 is the earliest enactment in this connection, but this remained a dead letter. Consequently, during the last two decades or so, legislation has been enacted by the State Governments to regulate the activities of the moneylenders. The most common features

of the Acts are the registration or licensing of moneylenders (who are required to maintain proper books of accounts) and fixation of maximum rates of interest on secured as well as unsecured loans. These rates vary from State to State; thus, the rate for unsecured loans varies from $5\frac{1}{2}$ per cent in Madras to 24 per cent in Uttar Pradesh. But it is known that even this Act has not been, by and large, effective, mainly because alternate sources of credit were not adequately developed. This aspect of the matter received the special attention of the Reserve Bank Committee on Rural Credit Survey. The Committee favoured the substitution, as early as possible, of the private moneylending agency by institutional credit, that is to say, the cooperative agency and also to some extent, direct Government lending. As already mentioned, the magnitude of lending by the co-operative organisation has been rising substantially. Even so, perhaps it will be many years before the private moneylending agency is reduced to a minor position as a source of rural credit. The main characteristics of private moneylending agency are its remarkable speed and flexibility of loan operations. However, the important factor that is tending to discourage the operations of private moneylenders is not the moneylending legislation as such, as the sweeping changes in the laws relating to ownership and tenancy of land. It is probable that the more well-to-do moneylenders are gradually turning to the establishment of rice mills, cottage industries, etc., etc. As a result of these various factors, there is no doubt that the importance of the co-operative credit system will grow rapidly.

Credit Needs of Agriculture and Problem of Mobilisation of Rural Savings

In agriculture, as in manufacturing, credit is required both for production and marketing. The various steps that have been taken to expand the flow of institutional and Government credit to the rural sector will assist predominantly marketing as well as *current* agricultural operations. In other words, the flow of credit for *long-term* investment in agriculture is still likely to be of small dimensions. It is true, as already mentioned, that investment by Government itself in projects of agricultural improvement and irrigation will take care of a substantial part of the requirements of rural investment. Even so, there would be

need for a considerable measure of private investment. However, it could be argued that insofar as the short term requirements of the rural population are satisfactorily met by institutional agencies the agriculturist could divert his own resources to long-term investment. Since rural investment is largely labour intensive it may be considered that given proper organisational effort it should not create much of a financing problem. A fuller utilisation of the potential labour force of the agriculturist's family itself as well as joint effort by the agricultural families should do the trick to a large extent. The Government has fully realised this and an important objective of the community development programme is to mobilise the rural labour in rural investment. So far, not much has been achieved in this direction, and it may not be realistic to pin too much faith to this, which means normal arrangements for the provision of finance have to be thought of.

In connection with the organisation of farming itself, an important decision taken by Government recently is the encouragement of co-operative farming. This has met with a lot of opposition and, in fact, was one of the developments responsible for the establishment of a new political party. Whether or not co-operative farming is desirable and practicable, there can be no two opinion regarding the need to develop service co-operatives.

There is also the problem of mobilising, to a larger extent than is now being done, monetary savings in the rural sector. It is true that per capita incomes in rural areas are very small, but even small per capita additions to savings in a sector that accounts for about 50 per cent of the national income will be of considerable assistance. An important form of saving in the rural areas is gold and silver to which a brief reference has already been made in Chapter 1. This is a habit which is slow to die and upto a point has to be tolerated. However, with the various measures taken recently to curb smuggling of gold, the investment by the community as a whole in gold is likely to have come down. Positive steps should also be taken to divert savings to other media, in particular small savings. In recent years, the postal department has embarked on a substantial expansion of the postal savings banks, but there is undoubtedly

scope for accelerating the pace. The small savings organisation is gearing itself to mobilise larger resources from the rural as well as urban areas. In this connection, it is for consideration whether the rates of interest paid on the postal savings bank deposits cannot be raised, having regard to the generally higher level of rates prevailing in the rural areas. There is of course the sixtyfour dollar question whether saving is interest elastic. Since it has not been clearly established that the saving is not interest elastic, there is no harm in trying the payment of higher rates, as an experimental measure, on relatively small sums, say upto Rs. 2,000. In place of the present $2\frac{1}{2}$ per cent, something like $4\frac{1}{2}$-5 per cent may be offered. Inevitably, this will put pressure on the deposit and other rates of commercial banks too, but one must think of the likely long-range benefits.

The land mortgage banks have also begun recently to issue a special type of debentures, called rural debentures, with a view to tapping rural savings. These debentures, which are issued only to individuals, have a relatively short maturity (say 5 - 8 years as compared to 15 years in the case of the normal series of debentures) and carry a somewhat higher rate of interest than the ordinary issues. The debentures are being issued soon after harvest and kept on tap for a long time. Deposits are also accepted throughout the year for being exchanged into debentures when issued. The results so far are modest but perhaps they are not by any means discouraging. The Life Insurance Corporation is also trying to issue policies to suit the requirements of the rural population. These measures would no doubt help to mobilise larger savings, but they need to be supplemented by higher taxation of agricultural incomes. However, it is well to recognise that it is desirable not to think of mobilising rural savings for use in non-rural sectors. Agricultural investment has to expand considerably so that we may not prolong unduly the significant dependence on imports. Besides, any marked expansion of consumer goods industries would also require larger flow of farm products. Therefore, there is need for maximising the resources available for rural investment.

Integration of the Organised and the Unorganised Sectors.

It was mentioned in the beginning of this chapter that the capital market in the rural sector is largely unorganised in

character. This should not give the impression that there is a completely water-tight division between the organised and unorganised sectors of the capital market, be it rural or urban. There is always some movement of funds between the two sectors. The Rural Credit Survey Committee made rough estimates of the source of funds for the rural sector from that sector as well as from the urban sector (on the basis of the location of the lender). The four methods they employed gave widely different percentages but three of them indicated that the major part (58 to 72 per cent) of rural borrowing was from the urban sector. The Committee also found that urban moneylenders depend to a not insignificant extent on commercial banks, for their working funds, in the same way as the indigenous bankers seek facilities for rediscount of *hundies* at the commercial banks. Urban traders also provide some finance for marketing of crops. Since the urban sector is subject to the influences of the organised capital market to a not insignificant extent, it may be said that the unorganised sector will feel the impact of the changes in the organised sector. Stringency in the organised market, for instance, is bound to be reflected in the unorganised rural and urban sectors also, but may be with a time lag; possibly also, the magnitude of impact, especially on the pattern of interest rates, may not be the same as in the organised sector.

The co-operative credit organisation could become the connecting link between the organised and the unorganised sectors of the capital market, as in respect of the money market. In fact, in respect of the rural sector the distinction between money and capital markets is even less significant than in respect of the urban sector. With the rapid expansion of co-operative sector that has been undertaken, the unorganised sector of the money and capital markets will progressively decrease and a unified market will emerge.

The co-operative institutions themselves will receive progressively larger assistance from the largest of the commercial banks, namely, the State Bank of India and probably from its subsidiaries too. Besides, the commercial banks themselves, the State Bank of India in particular, have embarked on a rapid expansion of branches in relatively smaller places. The co-operative and commercial banks are being given liberal remit-

tance facilities. Further, the debentures floated by the land mortgage banks are bought by financial institutions in the organised sector. Also, warehousing facilities are being extended and these would further assist the flow of funds to the rural sector. Government is doing much, including the provision of financial assistance, to develop rural industries. Finally, as already mentioned, the role of the Reserve Bank in the provision of rural credit has been expanding significantly. In these various ways, the integration of the organised and the unorganised sectors is proceeding.

Role of the Reserve Bank

In all this, the role of the Reserve Bank of India is tending to be pivotal. Few aspects of the working of the Reserve Bank have been so conspicuous, in comparison with foreign central banks generally, as its role in the sphere of rural finance. The importance of agricultural credit in the scheme of central banking was recognised quite early by the framers of the Reserve Bank of India Act, which contained a provision (Section 54) for the setting up of a special Agricultural Credit Department. For various reasons not much was done by the Bank in the field of rural credit in the first 15 years of its existence, but from 1950 onwards progress has been rapid, in particular after the submission of the Report of the Bank's Rural Credit Survey Committee in December 1954.

The most conspicuous feature of the Reserve Bank's role in the sphere of agricultural credit is the rapid rise in the scale of its lending to the co-operative sector. The Bank provides all the three types of credit, viz., short, medium and long-term, though the first is the most important. The short-term credit is for periods not exceeding 15 months, granted to State co-operative banks, in respect of seasonal agricultural operations and marketing of crops and 12 months in respect of production or marketing activities of cottage and small-scale industries. The medium-term loans are given, for periods between 15 months and 5 years, to State co-operative banks. Long-term loans, upto a maximum period of 20 years, are given to central land mortgage banks, and also to State Governments for enabling them to subscribe to the share capital of co-operative credit

institutions. The short and medium-term advances are mostly made at a concesssional rate of 2 per cent below Bank rate (which is at present 4 per cent). For the provision of long and medium term credit the Bank set up in 1956 two special Funds, of which the more important is the National Agricultural Credit (Long Term Operations) Fund, which now stands at Rs. 30 crores. This Fund is also used for the purchase of debentures issued by land mortgage banks; the Bank subscribes upto a maximum of 20 per cent of any issue.

The outstanding amount of the Reserve Bank's loans and advances to State co-operative banks, for seasonal agricultural operations, as at the end of 1959 was Rs. 71 crores, as compared to only Rs. 6.45 crores at the end of June 1952. As of the same date, i.e. end of 1959, the Bank's medium-term and long-term loans (to State Governments) stood at Rs. 5.7 crores and Rs. 13.4 crores, respectively.

Role of the State Bank of India

The role of the State Bank of India (and consequently its associated banks) is also likely to grow in the sphere of rural credit. As a matter of fact, the establishment of the State Bank of India (as a successor institution to the former Imperial Bank of India) was in pursuance of the recommendation of the Rural Credit Survey Committee, which desired the Bank to play an important role in the provision of rural credit. The activities of the Bank in this regard fall into four separate but closely inter-related fields. These are:-

(1) general assistance leading to the development of rural credit through provision to co-operative banks of facilities for remittance of funds and for short-term accommodation, subscription to the debentures of land mortgage banks etc.;

(2) provision of financial accommodation to co-operative marketing and processing societies;

(3) assistance to the scheme of warehousing in the country; and

(4) co-ordination of its policies and activities with those of the co-operative banking institutions.

Warehousing Corporations

Another recent institutional arrangement that will assist marketing and indirectly the provision of credit facilities is the establishment of the Central Warehousing Corporation and State Warehousing Corporations for the setting up of warehouses. These institutions work under the aegis of the National Co-operative Development and Warehousing Boad, an organ of the Central Government, set up in August 1956. The Board gets allotment of funds from the Central Government for investment in the share capital of the Central Warehousing Corporation and for making loans to the State Governments for subscribing to the share capital of co-operative societies and the State Warehousing Corporations, which have now been set up in all the States. The Central Warehousing Corporation, which was set up in March 1957, has an authorised capital of Rs. 20 crores. As of the end of March 1959, out of a subscribed capital of Rs. 5.5 crores, the National Co-operative and Warehousing Board's share alone was Rs. 4.0 crores. The State Bank of India held shares of Rs. 1 crore.

The Co-operative Credit Structure — Statistical Analysis

The Indian co-operative credit system is federal in character. At the top is the State co-operative Bank and at the bottom is the primary society; in between there are the co-operative central banks. It is the primary societies that account for the bulk of the credit extended to the individual borrowers, the credit of the other agencies being given mostly to the primary societies. The relevant data are given in Table 53, for the year 1957-58 (the latest year for which data are available) and for 1951-52, the year to which the Reserve Bank's rural credit survey related. The data are given for co-operative *credit* institutions only. So far as the operations of these institutions go, we should take into account only the sums advanced to *individuals*. The adding up of the figures for all the types of institutions to indicate the extent of co-operative financing would be most misleading.

TABLE 53

STATISTICS OF THE CO-OPERATIVE CREDIT INSTITUTIONS — AS AT THE END OF 1951-52 AND 1957-58**

(Amount in Rs. crores)

		Membership		Capital			Deposits	Loans Outstanding		
	Number	Individuals	Total	Government	Individuals	Total	Individuals	Borrowings	Individuals	Total
	1	2	3	4	5	6	7	8	9	10
State Co-operative Banks										
1951-52	16	9172	23272	—	—	1.90	12.80	11.27	1.83	20.01
1957-58	21	8609	32181	4.00	0.32	8.47	19.02	51.69	3.74	74.73
Central Co-operative Banks										
1951-52	509	118406	231318	—	—	4.62	26.75	12.07	3.06	35.91
1957-58	418	147298	322819	3.21	1.59	17.07	44.38	49.47	3.59	100.99
Primary Credit Societies: (Agricultural)										
1951-52	107925	48 lakhs	—	—	—	8.92	4.21	23.15 (Govt. 0.48)	33.66	33.66
1957-58	166543	102 lakhs	—	2.21	26.01	28.22	8.26	82.74 (Govt. 1.60)	107.10	107.10

TABLE 53 (Contd.)

	1	2	3	4	5	6	7	8	9	10
Primary Credit Societies:										
(Non-Agricultural) 1951-52	7962	23 lakhs	—	—	—	13.36	36.52	3.79 (Govt. 0.28)	44.36	44.36
1957-58	10430	37 lakhs	—	0.02	24.00	24.02	55.69	7.21 (Govt. 0.59)	79.33	79.33
Land Mortgage Banks										
Central 1951-52	6	34175	34579	—	—	0.44	0.15†	(Deb. 7.83) (Govt. 1.38)	8.05	8.05
1957-58	17	150944	151483	1.22	0.47	2.26	0.37	22.52 (Deb. 20.48) (Govt. 1.45)	6.27	19.82
Primary										
1951-52	289	213814	—	—	—	0.58	0.20†	6.56*	6.96	6.96
1957-58	347	375980	—	—	—	1.07	0.19	12.42	13.08	13.08

† Loans and deposits from banks, societies, individuals and other sources.

* Excludes debentures of Rs. 0.08 crore issued by the Bombay State Primary land mortgage banks.

** The years refer to the co-operative years, lasting from July 1 to June 30

Source: Reserve Bank of India, *Statistical Tables Relating to the Co-operative Movement in India.*

The table brings out that in the six-year period the co-operative credit system recorded a substantial growth. The membership more than doubled in the case of primary agricultural credit societies. The aggregate deposits of individuals, for all categories of co-operative credit institutions, rose from Rs. 81 crores at the end of 1951-52 to Rs. 128 crores at the end of 1957-58. In the same period, loans to individuals rose from Rs. 92 crores to Rs. 213 crores, the largest rise being in the case of the primary agricultural credit societies. The volume of credit at the end of 1957-58 constituted something like 20 per cent of the credit extended by the commercial banks.

In the case of the land mortgage banks, the loans to individuals at the end of 1957-58 amounted to a little under Rs. 20 crores, a very small sum indeed. It would appear that an important reason for this is the complications arising from tenancy reforms in most of the States, although in one State it is stated that tenancy reform actually brought in larger business. In the last few years, the annual floatation of debentures by the central land mortgage banks is of the order of Rs. 3 - 4 crores, the maturity varying from 8 to 20 years. From the data available for 1957-58, it would appear that a good part of the debentures is taken by the co-operative institutions. Thus, out of a total issue of Rs. 3.71 crores, the co-operative institutions purchased debentures for Rs. 1.83 crores. Among others, small amounts were bought by the Reserve Bank and the State Bank of India, namely, Rs. 14.87 lakhs and Rs. 36.50 lakhs. From the Reserve Bank's annual report it is gathered that the Bank's contribution in 1958-59 was only Rs. 1.69 lakhs out of a total issue of Rs. 3.13 crores by the land mortgage banks.

It will also be observed that a very large part of the loans given by the various agencies, with the exception of the non-agricultural credit societies, was financed by borrowed funds, which ultimately came from the Reserve Bank in a large measure. The amount of deposits of individuals in the case of the primary agricultural credit societies as well as their rise in the six-year period was of small dimensions. In the case of the credit societies the rise in deposits was Rs. 4 crores, from Rs. 4.21 crores to Rs. 8.26 crores. What a grand sum, for a membership of over 10 million! In the case of the non-agricultural

credit societies, the deposits are much more important, namely, Rs. 54 crores at the end of 1957-58 as compared to Rs. 37 crores at the end of 1951-52.

It will also be noticed that the State Governments have contributed to the share capital of the co-operative institutions, the largest (absolutely as well as percentage-wise) being in respect of State co-operative banks. The total of Government's contribution to share capital was Rs. 10.65 crores in respect of credit societies and Rs. 5.85 crores in respect of non-credit societies, making a total of Rs. 16.49 crores. The State Governments have also granted loans, to a small extent, to the co-operative institutiions.

It cannot be said that the rapid growth of the co-operative sector in recent years is entirely a healthy one. The co-operative credit structure has still many weak elements. There have been heavy overdues in respect of the loans given by the co-operative credit societies. The Reserve Bank of India has been doing its best to promote the growth of the co-operative organisation on sound lines and in particular to ensure that co-operative credit is directed primarily to productive uses and that it is promptly repaid. As a complement to the provision of more liberal financial assistance, the Bank has undertaken a scheme of voluntary inspection of the co-operative banks.

It is hard to say to what extent the hope of the authorities that 'co-operation must succeed' will eventually be realised, but the experience of the last few years does not suggest that the hope be abandoned.

Chapter 10

THE PATTERN OF INTEREST RATES

Broad Influences on the Pattern of Interest Rates.

If *price* is the heart of a commodity market, the *rate of interest,* which is the price for the use of money, is the heart of the money and capital markets. Even as in respect of any commodity there is no single price — there being a complex of prices for the different varieties of the commodity — there is no single rate of interest. But this is not to say that the various rates are not related to one another; in fact, they are generally integrated into a harmonious pattern.

Broadly speaking, the different rates of interest reflect three factors, namely, the element of risk, the period of the loan and the marketability or liquidity of the security. The greater the probability and magnitude of risk the higher the rate. Likewise, the longer the period of the loan, the higher the rate, not so much because of the risk of default as that of depreciation in the capital value, on account of a possible rise in the rate of interest during the period of the loan. The greater the marketability the lower the rate of interest. Marketability is also influenced by statutory provisions and practices with regard to the transferability of assets and the investment pattern of institutional investors in particular. The relationship between short-term rates and long-term rates of interest is a very interesting aspect of the theory of interest, which it is beyond the scope of this book to consider in any detail. It would appear that each reacts on the other as, to some extent at least, long and short-term borrowings are alternatives. If the long-term rate is steadily rising, for instance, the short-term rate should also rise since there would be a tendency for the borrowers to switch from long to short-term loans, and for lenders to shift funds into the long-term market. The short-

term rates proper are those which rule in the *money* market, namely, inter-bank call rate, the Treasury bill rate, the commercial bill rate, the deposit and lending rates of commercial and co-operative banks and finally the bank rate, which is the lending rate of the central banks. The long-term rates or the *capital* market rates refer to the Government and corporate bond rates, yield on ordinary and preference shares etc. It is observed that the amplitude of variations of the long-term rate is smaller than that of the short-term rate. For instance, during a period of sharp rise in the short-term rate, the long-term rate would rise less sharply and generally be below the short-term rate, while in a period of rapidly falling short-term rate, the long-term rate would decline less and also be higher than the short-term rate. The long-term rate is in the nature of a mean of the short-term rates.

It has been mentioned earlier that there is no water-tight division between the money and capital markets. Funds move both ways, but there are also limits to this flow, depending upon the nature of business of the borrower and the lender and also on the legislative provisions concerning investment of institutional funds. In India, institutions like the Life Insurance Corporation and provident funds are compelled to invest a substantial part/whole of their funds in Government securities, no matter what the rate of interest is. Apart from statutory restrictions, different investors have different preferences, which are not always rational. In other words, there are a number of separate sub-markets of the capital market, there being always an inter-sectoral flow, sometimes large and sometimes small. Consequently, there is a complex of interest rates.

It is necessary to mention that to a substantial extent fiscal and monetary policies also influence the pattern of interest rates. In the present day world, Government is an important borrower of funds and its borrowing operations exercise a profound influence on interest rates. Since Government is generally a borrower of short-term as well as long-term funds, it influences the short-term as well as long-term rates. In fact, the rate at which the Government borrows is generally considered to be *the* rate of interest; thus, the Treasury bill rate is considered to be the typical or representative short-term rate, while the rate on long-term Government bonds is regarded as the long-term rate

of interest. In few countries does the Government have to face the full competition of other borrowers for funds; it is generally a preferential or favoured borrower. Also, the Government could approach the central bank for accommodation, both short-term and long-term, though in a few countries there are restrictions on the resort to the central bank.

The fiscal operations of Government directly affect the inducement of the public to invest as well as the resources available for investment. Government has also other direct methods of regulating investment, which have been discussed briefly in Chapter 2 with reference to Indian conditions. In other words, it is not merely the supply of capital funds that it is subject to regulation but also the demand for them. Further, some types of interest rates are subject to direct Government regulation.

The policies of the central bank too exercise an important influence on the pattern and movement of interest rates. Generally, the central bank's influence is predominant in the case of the short-term or money market rates. The traditional view is that the central bank should deal only in short-term assets; that is, lend short-term only and hold short-term paper only, the most desirable ones being the commercial bill of exchange (not important these days) or the Treasury bill. The long-term rate, on the other hand, should be determined by the free-play of forces of supply of and demand for capital funds. The presumption behind the above reasoning is that central bank credit is inherently inflationary and that such credit should not be employed in the market for long-term funds lest it should lead to distortion of the pattern of investment, which must be built on the solid foundation of genuine savings and preferences of investors. In practical terms this means that open market operations should be confined to Treasury bills and other short-dated Government bonds. This view is now held most tenaciously in the U.S.A., but elsewhere, although there is broad support for this view, it is not adhered to rigidly. Central banks engage in the purchase of even long-term securities.

Finally, interest rates in a country are influenced by the rate structure in other countries, provided there is no obstacle to the free movement of funds. There are not many countries today

which permit free movement of funds across the national frontiers, though in the last few years, the war and post-war restrictions have been eased. Even otherwise, there is always a certain reluctance to invest in foreign countries. However, within Western Europe, between the U.S.A. and Western Europe and between the U.S.A. and Canada, there is a fairly large flow of funds, with the result that changes in the rate of interest in one country produce changes in the others in the same direction, the extent of the change and the time lag varying from country to country, depending on its international economic position.

The Interest Rate Structure in India

With the above background, the pattern of interest rates in India may now be studied. The rates of interest prevailing in the organised sector of the capital and money markets are naturally lower than those ruling in the unorganised sector, both rural and urban. In the organised sector, the lowest rates naturally obtain in respect of Government bonds and the bonds of quasi-Government bodies like municipalities and port trusts. In India, particularly since the inauguration of the Five Year Plans in April 1951, the requirements of the public sector have considerably increased and hence Government and semi-Government bodies account for the major share of the funds raised from the market. As already mentioned, the statutory provisions are such that institutional investors are compelled to invest a large part of their funds in Government and semi-Government securities. Hence there is a certain assured investment of funds in Government securities. To this extent the rate of interest on Government bonds loses some of its significance. In other words, Government is somewhat in the position of a monopoly buyer. This is an important reason for the Government bond yields being lower than those in many of the developed countries. However, Government has to attract funds from other classes of investors too since the contributions from sources like the Life Insurance Corporation are not large enough, and in any event Government has to see that other holders do not disinvest their holdings, as otherwise the net sale of Government bonds may not be significant. Consequently, the coupon rate on Government

bonds has shown variations from time to time. It should also be noted that interest rates on securities other than Government bonds are much higher.

Broadly speaking, during the war and the immediate post-war years the interest rates were low, in pursuance of the 'cheap' money policy but from 1946 onwards there was a gradual rise in interest rates, which gathered further momentum with the raising of the Bank rate (which had remained unchanged practically since the inception of the Reserve Bank in 1935), from 3 to $3\frac{1}{2}$ per cent in November 1951. Thereafter, there was a fairly long period of stability. In 1956 and 1957, however, the rates tended to move up, as a result of acute stringency on account of the substantial rise in investment activity and imports. The Bank rate was raised to 4 per cent in mid-May 1957. But, for over a year thereafter there was some decline in the pattern of rates, both on account of the slowing down of tempo of investment activity and the severe tightening of import restrictions, which led to a decline in bank credit and a substantial increase in bank deposits.

An important point that has to be borne in mind in considering the level of interest rates in India in recent years is that the Government has not attempted to raise through market loans the gap in resources between expenditure and current revenue and small savings receipts. There has been free resort to the Reserve Bank of India; the arrangement is for the Government to sell to the Bank what are known as *ad hoc* Treasury bills, whenever it is short of funds. This process began in the fiscal year 1954-55 and the issue of bills reached the record figure of Rs. 476 crores in the year 1957-58. As compared to this quantum of deficit financing, the amount raised by Government in the form of marketable loans has been small and in fact it could be stated that even that in part owed its origin to deficit financing. It is not suggested that it would have been possible to avoid resort to deficit financing altogether and raise the same resources through appropriate adjustment of the rate of interest on Government bonds. There is a definite limit to the resources that can be raised through borrowing, no matter what the rate of interest is. But what is indicated is that in the absence of the more or less automatic resort to the Reserve Bank, the pattern of rates would

have been different and certainly higher than at present, though in the long run deficit financing has also the effect of leading to higher demand for funds and an upward pattern of interest rates. Possibly this would have brought in larger voluntary savings, though the question whether saving is interest-elastic continues to be an unresolved one; nor is there unanimity of opinion concerning the effects of variations in interest rate on the demand for funds, for fixed investment as well as inventory building. But one gathers the impression that in the discussions on the subject it is not sufficiently realised that the rate of interest is a price, which must, despite all limitations, reflect the changes in supply and demand and also restrain/stimulate supply and demand. It is perhaps more correct to say that if perceptible effects are to be produced, the variations in the rate of interest have to be rather large than to say that it has no effect at all on the supply of and demand for investible funds, though what constitutes a 'large' variation differs from country to country. The rate of interest is still useful in separating 'the sheep from the goats'.

The data on the complex of interest rates in India in the last few years are presented in Tables 54 - 61. They relate to (i) short-term as well as long-term rates, (ii) the borrowings of Government and semi-Government bodies, (iii) joint stock companies, (iv) lending rates of co-operatives and land mortgage banks and (v) the lending rates of the various financial corporations. Further, data are also given on the average yield on Government securities and ordinary shares of joint stock companies, that is, dividend expressed as a percentage of the market value of the shares. Dividend is not pure interest; it includes an important element of profit. In other words, the yield on ordinary shares reflects both the prevailing rate of interest and the profitability of the company.

It will be noticed that the interest rate on semi-Government bonds is only slightly higher than that of Government bonds, which is explained by the fact that these bonds carry Government guarantee; also, the rate offered on State Government bonds is slightly higher than that on the Central Government bonds, which is the key rate, now ruling at about 4 per cent for long dated issues. The lending rates of the various financial corporations, namely 6 - 7 per cent, are 2 to 3 per cent higher

TABLE 54

SHORT-TERM INTEREST RATES

As at the end of	Bank Rate	Treasury Bill Rate	Inter-Bank Call Money Rate in Bombay	Deposit Rate in Bombay for 3 months	Bazar Bill Rate in Bombay	Interest Rate charged by Scheduled Banks on Secured Advances
1951-52	3½	—	2¾ — 3-1/8	3 — 3¼	9	
1952-53	,,	2.44	2¾ — 3	3	9	
1953-54	,,	2.69	3	2¾ — 3¼	9¾	
1954-55	,,	2.56	2¾ — 3	2¾ — 3	9¾	
1955-56	,,	2.53	3¼ — 3-3/8	3¼ — 3½	10⅛	5.20(a)
1956-57	,,	—	3½ — 3¾	4⅛ — 4¼	11¼	5.19*
1957-58	4	—	3 — 4-3/16	3 — 4-11/16	9¾ — 11¼	5.51*
1958-59	,,	2.76	3½	3 — 4	9 — 9¾	5.58*
December 1959	,,	2.39	2½ — 3½	3 — 3½	9 — 10-3/6	

(a) As in March 1956.

* Average for January to June.

TABLE 55

USUAL RATES OF INTEREST CHARGED BY CO-OPERATIVE PRIMARY CREDIT SOCIETIES DURING 1957-58

Nature of Society		Rate (per cent per annum)
1. Small agricultural credit societies	...	$6\frac{1}{4}$ — 10
2. Large-sized agricultural credit societies	...	$6\frac{1}{4}$ — 10
3. Agricultural marketing societies	...	$6\frac{1}{4}$ — $9\frac{1}{2}$
4. Non-agricultural credit societies	...	$6\frac{1}{4}$ — $9\frac{1}{2}$

Source: *Statistical Statements relating to the Co-operative Movement in India*, 1957-58.

than their borrowing rates, which is necessary to cover their administrative expenses and provision for reserves. In the case of the co-operative institutions taken as a whole, however, the rates which are charged by the primary credit societies (which vary from State to State and from society to society, the usual rates ranging from $6\frac{1}{4}$ to 10 per cent) are substantially higher than the rate of 2 per cent at which the Reserve Bank provides most of the funds to the State co-operative banks; this is partly due to the fact that the State co-operative banks and the co-operative central banks have to keep a margin to cover their expenses. One gathers the impression that to a not insignificant extent the cost of co-operative credit in a number of States is almost as high as that provided by indigenous bankers and moneylenders. It must, however, be mentioned that the Reserve Bank has been making earnest efforts to bring down the rates charged by the co-operative institutions to the ultimate borrower.

It will also be seen that the rates of interest on securities offered by the joint stock companies are significantly higher than those on Government and semi-Government issues. The spread is of the order of about 2 per cent in respect of debentures and 3 - $3\frac{1}{2}$ per cent in respect of preference and ordinary shares, on an average. Debentures of good companies now carry a rate of about $6\frac{1}{2}$ per cent (taxable), while smaller companies, in particular the plantation companies, have to pay 6 - 7 per cent tax free. Preference shares carry a rate of $6\frac{1}{2}$ - 7 per cent, free of income tax. A part of the spread, over and above the rate on

TABLE 56

INTEREST RATE ON RECENT LOAN FLOATATIONS OF CENTRAL AND STATE GOVERNMENTS

Year of Issue	Coupon Rate*	Issue Price	Redemption Yield	Period
		Central Government		
1956-57	$3\frac{1}{4}$%	98.00	3.62	6 years
,,	$3\frac{1}{2}$%	98.50	3.67	11 years
,,	$3\frac{3}{4}$%	98.50	3.87	18 ,,
1957-58	$3\frac{3}{4}$%	99.50	3.81	10 ,,
,,	4 %	100.00	4.00	15 ,,
,,	$3\frac{1}{4}$%	**		5 ,,
1958-59	$3\frac{1}{2}$%	98.75	3.78	5 ,,
,,	$3\frac{3}{4}$%	99.50	3.81	10 ,,
,,	4 %	100.00	4.00	15 ,,
,,	$3\frac{1}{2}$%	98.50	3.68	10 ,,
,,	$3\frac{1}{2}$%	98.80	3.66	9 ,,
1959-60	$3\frac{1}{2}$%	98.85	3.64	10 ,,
,,	4 %	100.00	4.00	20 ,,
,,	$3\frac{1}{2}$%	99.40	3.57	10 ,,
,,	$3\frac{3}{4}$%	99.65	3.78	15 ,,
		State Governments		
1956-57	4 %	99.25 to 100.00	4.00 to 4.08	12 years
,,	4 %	100.00	4.00	14 ,,
1957-58	$4\frac{1}{4}$%	99.75	4.28	12 ,,
,,	$4\frac{1}{4}$%	98.75	4.38	12 ,,
1958-59	$4\frac{1}{4}$%	99.00 to 100.00	4.25 to 4.35	12 ,,
,,	$4\frac{1}{4}$%	99.75	4.28	13 ,,
1959-60	4 %	99.00 to 100.00	4.00 to 4.11	12 ,,

* The rates are gross, i.e., before deduction of income and super taxes.

** Issue price is not given here since this amount was not issued to the public but taken straightway on the Central Government cash balance investment account.

TABLE 57

INTEREST RATE ON LOANS OF MUNICIPALITIES, PORT TRUSTS ETC.

Year of Issue	Coupon Rate	Issue Price	Redemption Yield at Issue Price	Period of Maturity
Port Trusts				
1951	$3\frac{1}{2}$%	99.25	3.59	10 years
1953	4 %	99.25	4.09	”
1953	4 %	97.00	4.18	30 years
1955	4 %	97.25	4.16	”
1956	4 %	97.25	4.16	”
1957	$4\frac{1}{4}$%	99.50	4.28	”
1958	$4\frac{1}{4}$%	98.25	4.35	”
Municipalities				
1951	$3\frac{3}{4}$%	100.00	3.75	15 years
1952	4 %	97.75	4.24	12 years
1953	4 %	99.25	4.09	10 years
1954	4 %	99.75	4.03	”
1954	$4\frac{1}{4}$%	100.00	4.25	15 years
1955	4 %	99.50	4.05	12 years
1956	4 %	99.50	4.05	”
1957	$4\frac{1}{4}$%	98.75	4.38	”
1958	$4\frac{1}{2}$%	99.50	4.55	”
1959	4 %	99.00	4.12	10 years

Note: The interest on all the loans is gross, i.e., income and super taxes, if any, have to be paid thereon.

Government securities, is due to the fact that the return on corporate securities contains a risk premium; besides, in the case of the ordinary shares, there has to be some compensation for the fact that the return is uncertain. That is why in respect of first class shares, where both the abovementioned risk/uncertainty element is very small, the yields are comparatively low. Thus, for instance, the income tax free yield of Tata Steel and Indian Iron is only 4.2 per cent.

The question may be asked if by offering higher return there is the likelihood of the private sector appropriating for itself a relatively major share of the investible funds of the community. There is always some competition between Government and the private sector for funds but it is unlikely that this can reach uncomfortable dimensions so far as Government goes.

TABLE 58

BORROWING (THROUGH BONDS) AND LENDING RATES OF THE STATE FINANCIAL CORPORATIONS AND THE INDUSTRIAL FINANCE CORPORATION OF INDIA

Borrowing Rate

Name of the State Corporation	Date of Issue	Year of Repayment	Rate of interest per annum	Issue price (Rs.)	Amount offered (Rs. crores)
1. Madras	Sept. & Oct. 1956	1966-71	$4\frac{1}{4}$	100.00	0.50
„	October 1958	1968	$4\frac{1}{2}$	99.00	1.00
2. Bombay	November 1957	1967	$4\frac{1}{2}$	98.50	1.00
3. Punjab	January 1958	1968	$4\frac{3}{4}$	98.50	1.00
4. Kerala	March 1958	1968	$4\frac{3}{4}$	98.50	0.50
5. West Bengal	March 1958	1968	$4\frac{3}{4}$	99.00	0.50
6. Bihar	September 1958	1968	$4\frac{1}{2}$	98.00	1.00
7. U.P.	October 1958	1968	$4\frac{1}{2}$	99.00	0.50
8. Assam	October 1959	1971	$4\frac{1}{4}$	99.50	0.50
Industrial Finance Corporation	November 1957	1967	$4\frac{1}{2}$	99.00	4.50
of India	November 1958	1968	$4\frac{1}{4}$	99.00	4.00
„	October 1959	1971	4	99.75	5.00

LENDING RATE

State Financial Corporations: Varies from Corporation to Corporation, from 6 to $7\frac{1}{2}$ per cent and if rebate for prompt payment is taken off from 6 to 7 per cent.

Industrial Finance Corporation of India: 7 per cent; exclusive of rebate, $6\frac{1}{2}$ per cent.

Industrial Credit and Investment Corporation of India: $6\frac{1}{2}$ per cent on rupee loans; $7\frac{3}{4}$ per cent on foreign exchange loans, plus $\frac{1}{4}$ per cent fee charged once, when the loan contract is signed.

TABLE 59

YIELDS (TAX-FREE) ON GOVERNMENT AND INDUSTRIAL SECURITIES

Average for March	Government of India Loans				Industrial Securities		
	Short-dated (a)	Medium-dated (b)	Long-dated (c)	Non-terminable (d)	Debentures	Preference shares	Variable Dividend Industrial Securities
1951	1.93	2.37	2.56	2.38	Not available		
1952	2.39	2.88	3.12	2.73	—do—		
1953	2.52	3.06	3.22	2.66	3.95	5.37	6.56
1954	2.70	3.14	3.27	2.67	3.75	5.29	5.50
1955	2.53	3.09	3.30	2.74	3.82	5.25	4.88
1956	2.46	3.05	3.14	2.87	3.84	5.27	5.56
1957	2.73	3.16	3.39	2.97	4.11	5.66	6.05
1958	2.56	3.15	3.47	2.98	4.20	6.15	7.24
1959	2.41	3.02	3.03	2.84	4.05	5.75	5.81
October 1959	2.29	2.74	2.84	2.80	4.07	5.63	5.35

(a) Below 5 years. (b) 5—10 years. (c) Above 10 years.
(d) 3% Conversion (non-terminable) Loan of 1946.

Note: Yields on Government of India loans are calculated to the earliest date of redemption, in respect of a single representative loan.

Tax-free yields are calculated, deducting income tax at maximum rate (25%) and surcharge (1.25% of income upto 1957 and 5% thereafter); that is, super tax, if any, has to be paid.

TABLE 60

DETAILS OF PREFERENCE SHARE AND DEBENTURE ISSUES

Preference Shares

Company		Amount (Rs. lakhs)	Rate of Interest	Face Value	Issue Price
1957					
Shri Gopal Paper Mills	...	75.00	7 % Tax free	Rs. 100	Par
Dalmia Cement (Bharat)	...	35.63	6 % —do—	Rs. 10	"
Shree Bhavani Cotton Mills	...	12.50	8 % Taxable	Rs. 100	"
The Britannia Engineering Co.	...	20.00	6 % Tax free	Rs. 100	"
Jeypore Sugar Co.	..	10.00	7 % —do—	Rs. 100	"
National Rubber Manufactures	...	10.00	6 % —do—	Rs. 100	"
1958					
Anil Hardboards	...	10.00	8 % Taxable	Rs. 100	"
Kirloskar Pneumatic Company	...	10.00	8 % —do—	Rs. 100	"
Gwalior Rayons	...	50.00	6 % Tax free	Rs. 100	"
Century Spinning & Manufacturing Co.	...	125.00	6 % —do—	Rs. 100	"
Walchandnagar Industries	...	46.50	7 % —do—	Rs. 100	"
1959					
Hind Cycles	...	30.00	6 % —do—	Rs. 100	"
Khandelwal Ferro Alloys	...	50.00	$7\frac{1}{2}$% —do—	Rs. 100	"
Standard Motor Products of India	...	20.00	$6\frac{1}{4}$% —do—	Rs. 100	"
Indian Rayon Corporation	...	52.93	7 % —do—	Rs. 100	"
Tata Iron & Steel Co.	...	371.91	$7\frac{1}{2}$% Taxable	Rs. 100	"
West Coast Paper Mills	...	30.00	6 % Tax free	Rs. 100	"
Indian Dyestuff Industries	...	22.50	6 % —do—	Rs. 100	"
Texmaco	...	100.00	$6\frac{1}{4}$% —do—	Rs. 100	"
Mandya National Paper	...	60.00	7 % —do—	Rs. 100	"
Star Paper Mills	...	70.00	7 % —do—	Rs. 100	"
1960					
Premier Tyres	...	50.00	$6\frac{1}{2}$% —do—	Rs. 100	"
Hindustan Aluminium Co.	...	250.00	6.3% —do—	Rs. 100	"

TABLE 59

YIELDS (TAX-FREE) ON GOVERNMENT AND INDUSTRIAL SECURITIES

Average for March	Government of India Loans				Industrial Securities		
	Short-dated (a)	Medium-dated (b)	Long-dated (c)	Non-terminable (d)	Debentures	Preference shares	Variable Dividend Industrial Securities
1951	1.93	2.37	2.56	2.38		Not available	
1952	2.39	2.88	3.12	2.73		—do—	
1953	2.52	3.06	3.22	2.66	3.95	5.37	6.56
1954	2.70	3.14	3.27	2.67	3.75	5.29	5.50
1955	2.53	3.09	3.30	2.74	3.82	5.25	4.88
1956	2.46	3.05	3.14	2.87	3.84	5.27	5.56
1957	2.73	3.16	3.39	2.97	4.11	5.66	6.05
1958	2.56	3.15	3.47	2.98	4.20	6.15	7.24
1959	2.41	3.02	3.03	2.84	4.05	5.75	5.81
October 1959	2.29	2.74	2.84	2.80	4.07	5.63	5.35

(a) Below 5 years. (b) 5—10 years. (c) Above 10 years.
(d) 3% Conversion (non-terminable) Loan of 1946.

Note: Yields on Government of India loans are calculated to the earliest date of redemption, in respect of a single representative loan.

Tax-free yields are calculated, deducting income tax at maximum rate (25%) and surcharge (1.25% of income upto 1957 and 5% thereafter); that is, super tax, if any, has to be paid.

TABLE 60

DETAILS OF PREFERENCE SHARE AND DEBENTURE ISSUES

Preference Shares

Company		Amount (Rs. lakhs)	Rate of Interest	Face Value	Issue Price
1957					
Shri Gopal Paper Mills	...	75.00	7 % Tax free	Rs. 100	Par
Dalmia Cement (Bharat)	...	35.63	6 % —do—	Rs. 10	,,
Shree Bhavani Cotton Mills	...	12.50	8 % Taxable	Rs. 100	,,
The Britannia Engineering Co.	...	20.00	6 % Tax free	Rs. 100	,,
Jeypore Sugar Co.	..	10.00	7 % —do—	Rs. 100	,,
National Rubber Manufactures	...	10.00	6 % —do—	Rs. 100	,,
1958					
Anil Hardboards	...	10.00	8 % Taxable	Rs. 100	,,
Kirloskar Pneumatic Company	...	10.00	8 % —do—	Rs. 100	,,
Gwalior Rayons	...	50.00	6 % Tax free	Rs. 100	,,
Century Spinning & Manufacturing Co.	...	125.00	6 % —do—	Rs. 100	,,
Walchandnagar Industries	...	46.50	7 % —do—	Rs. 100	,,
1959					
Hind Cycles	...	30.00	6 % —do—	Rs. 100	,,
Khandelwal Ferro Alloys	...	50.00	7½% —do—	Rs. 100	,,
Standard Motor Products of India	...	20.00	6¼% —do—	Rs. 100	,,
Indian Rayon Corporation	...	52.93	7 % —do—	Rs. 100	,,
Tata Iron & Steel Co.	...	371.91	7½% Taxable	Rs. 100	,,
West Coast Paper Mills	...	30.00	6 % Tax free	Rs. 100	,,
Indian Dyestuff Industries	...	22.50	6 % —do—	Rs. 100	,,
Texmaco	...	100.00	6¼% —do—	Rs. 100	,,
Mandya National Paper	...	60.00	7 % —do—	Rs. 100	,,
Star Paper Mills	...	70.00	7 % —do—	Rs. 100	,,
1960					
Premier Tyres	...	50.00	6½% —do—	Rs. 100	,,
Hindustan Aluminium Co.	...	250.00	6.3% —do—	Rs. 100	,,

TABLE 60 (Contd.)

Debentures

Company		Amount (Rs. lakhs)	Rate of Interest	Face Value	Issue Price	Period of maturity
1957						
The Gokak Mills	...	40.00	6 % Taxable	Rs. 1000	Par	10—15 years
Dunbar Mills	...	25.00	6 % —do—		Par	10—15 years
1958						
Premier Automobiles	...	160.00	6½% —do—	Rs. 100	Par	
National Carbon Co. (India)	...	100.00	6½% —do—	Rs. 5000	Par	10—15 years
Jay Shree Textiles	...	25.00	7 % —do—	Rs. 1000	Par	
Guest Keen Williams	...	150.00	6½% —do—	Rs. 1000	Par	8—13 years
Dunlop Rubber Company (India)	...	100.00	6½% —do—	Rs. 1000	Par	10—15 years
Shree Niwas Cotton Mills	...	30.00	6½% —do—	Rs. 1000	Par	12 years
1959						
Bowreah Cotton Mills Co.	...	20.00	6½% —do—		Par	9—14 years
Simplex Mills Co.	...	60.00	6½% —do—	Rs. 100	Par	10—15 years
Indian Aluminium	...	300.00	6¼% —do—	Rs. 100	Rs. 102	10 years

In the first place, Government itself will make some adjustment in its borrowing rates to suit the altered situation in the capital market. Secondly, joint stock companies would rarely wish to pay rates on their borrowing higher than what are strictly warranted. In fact, if any company wants to pay unusually high rates, the chances are it will *not* get the money from the public, since it is likely to arouse their suspicions regarding the standing of the company. Further, as explained in Chapter 2, the issue of capital, including the terms thereof, and investment by the private sector are subject to Government regulation, under the Capital Issues Control Act, the Industries (Development and Regulation) Act and the Exchange Control Act. It should be recognised that, by and large it is the private sector which is likely to feel the pinch in the matter of resources rather than the public sector. The Government is diverting a good part of the resources to investment in the public sector through taxation and deficit financing. In fact, a part of these funds is being diverted back to the private sector. Therefore, the private sector, especially the organised sector, cannot get more funds out of the market than it should; the Government can also curtail the amount of assistance it gives directly as well as through the various institutions, including the investment of life insurance funds in the shares and debentures of companies.

In Table 61 are given the prevailing rates of interest (and other terms) on Government's small savings schemes. For instance, the postal savings bank deposits carry a rate of 2 - $2\frac{1}{2}$ per cent, National Plan Savings Certificates 4.25 per cent (compound interest) if held to the full maturity of 12 years and the Treasury Savings Deposit Certificates 4 per cent (compound interest), if held to full maturity of 10 years.

The rates of interest prevailing in the unorganised sector are naturally much higher than in the organised sector, though data regarding these are not plentiful. The rates in the rural areas are higher than in the urban areas. The Bazaar bill rate (or the rate at which bills of small traders are discounted by shroffs), which may be regarded as the typical urban rate, is anywhere between 9 and 12 per cent. Some business passes at higher rates, namely, 12-15 per cent. Small industria-

TABLE 61

SCHEMES OF SMALL SAVINGS RUN BY GOVERNMENT — RATE OF INTEREST AND OTHER TERMS

Type of Small Savings	Rate of interest	Limits of holding etc.
1. Post Office Savings Bank Deposits	$2\frac{1}{2}$ per cent per annum upto a maximum of Rs. 10000 in the case of individual accounts and Rs. 20000 in the case of joint account and at 2 per cent per annum on the remainder and for institutions.	The maximum deposit is Rs. 15000 in the case of individual accounts and Rs. 30000 in the case of joint accounts. Public institutions can deposit any amount.
2. Twelve-Year National Plan Savings Certificates	On full maturity earns a simple interest of 5.41 per cent or a compound interest of 4.25 per cent, that is, Rs. 100 becomes Rs. 165 in 12 years.	Maximum limit for individual holdings is Rs. 25000, joint holdings Rs. 50000, local authorities and co-operative institutions Rs. 1 lakh, co-operative and scheduled banks Rs. 25000, charitable and religious institutions Rs. 1 lakh and provident funds without limit.
3. Ten-Year Treasury Savings Deposit Certificates	4 per cent per annum payable annually; premature encashment will be done at discount, which varies, depending upon the period for which the Certificate has been held.	The maximum amount that may be invested in these Certificates is Rs. 25000 for individuals and Rs. 50000 for joint holders and institutions, Rs. 1 lakh for charitable institutions and provident funds without limit.
4. Fifteen-Year Annuity Certificates	4.25 per cent (compound interest). (An investment of Rs. 3325 in these Certificates will fetch, for a period of 15 years a monthly payment of Rs. 25).	The maximum limit for individual holdings is Rs. 28000 and for joint holdings Rs. 56000.

TABLE 61 (Contd.)

Type of Small Savings	Rate of interest	Limits of holding etc.
5. Cumulative Time Deposit Scheme	There are two types of accounts: (i) 5 year account and (ii) 10 year account yielding 3.3 per cent and 3.8 per cent (compound interest) respectively. (A deposit of Rs. 100 per month in a five year account will fetch Rs. 6500 on maturity and in a 10 year account, Rs. 14500).	The total of the deposits made during the entire period of one's account or accounts where one has more than one account, shall not exceed Rs. 12000, exclusive of amounts withdrawn.

Note: Interest earned from investments in Post Office Savings Bank Deposits, 12-Year National Plan Savings Certificates, 10-Year Treasury Savings Deposit Certificates, the monthly payment to the investor in respect of the 15-Year Annuity Certificates and the interest on Cumulative Time Deposits are free of income tax and are not taken into account while calculating the total income for purpose of income-tax.

lists, contractors, etc. pay these high rates, especially where the loan is for relatively short periods. In the rural areas the rates vary anywhere from 10 to 35 per cent, though perhaps the usual rates range from 12 to 18 per cent. The ceilings fixed by the State Governments for rates of interest are evaded in a number of ways, since the private moneylender continues to be the main source of credit, though it is very likely that in recent years, with the marked expansion of co-operative credit, the rates charged by the moneylenders have recorded a decline.

From the foregoing it will be seen that on the whole the complex of interest rates ruling in India is by no means very low, as is generally supposed.

It would appear that by and large the interest rates in India are not affected by the trend of rates abroad. There is very little flow of Indian funds abroad; as regards inflow of foreign funds, there used to be some movement of short-term funds from London to India during the busy season, mainly through the exchange banks, but this has diminished to insignificant proportions in recent years, partly because of the higher levels of money rates prevailing in the U.K. As a matter of fact, the exchange banks have been large borrowers from the Reserve Bank. It is not suggested that the pattern of interest rates in India vis-a-vis the rates abroad will not have *any* effect on the movement of capital into India or out of India by foreign companies. However, the inflow of foreign capital is largely influenced by the profitability of investment in India and the nature of Government policies concerning foreign capital. It would appear that abroad there is latterly a growing impression that in both respects India is rather favourably situated for foreign capital to come in.

Chapter 11

SUMMING UP

The foregoing account, it is hoped, supports the view expressed in the introductory chapter that the Indian capital market is fairly well developed. The integration of the market is also proceeding well, with institutional intermediaries playing a progressively larger role. There has been a significant stepping up of the mobilisation of resources for investment, in the public as well as private sectors. While the public sector's share of investment is steadily rising, the private sector too is recording a rapid growth, and Government has taken many steps to promote saving and investment. In particular, there is at present an elaborate legislative code to protect the investors' interests; apparently, some of the enactments give the impression of scaring away enterprise, but in practice this has not, by and large, happened.

There is also a fairly well organised machinery to channelise savings into productive enterprise. The functions of company promotion, issue and underwriting are not however, so specialised as in the developed countries; on the contrary, to a considerable extent, the same agency, namely, the managing agents, combines all these functions and what is equally important, engages in day-to-day management also. Over the years, curbs are being placed on the managing agency system, but these are on the whole reasonable and should not, by and large, affect the system adversely. The principal curb is on the remuneration payable to the managing agents; the latest decision of Government to fix a slab system of remuneration, from 10 per cent of profits to 4 per cent on profits of over Rs. 1 crore should generally be regarded as reasonable. The desire to earn profits directly is not the only incentive to business enterprise. The running of an enterprise carries with it so many tangible and intangible benefits, prestige and a sense of creative activity, that few entrepreneurs would like to give up the managing agency form of business organisation. In any event, the

disappearance of the managing agency system is likely to be very very gradual, without giving rise to any difficult problems of transition. In the matter of supply of entrepreneurship, India is now very fairly well placed. The country's bottleneck is not so much business leadership as inadequacy of trained personnel of all types and at all levels, and saving. As a result of the marked growth in the volume and variety of investment activity, the functions of issue, underwriting etc. of capital are, in due course, bound to get specialised.

With the recent expansion of underwriting activity, under the leadership of the Industrial Credit and Investment Corporation of India, and the establishment of various finance corporations, the arrangements for the issue of new securities may be regarded as being generally satisfactory. In fact, the problem is now one of some duplication, raising questions of co-ordination, which it may be hoped will be satisfactorily tackled. It would appear that for at least some years to come there may be no need to set up any new institution for the provision of finance for industry. The working of the existing institutions should be streamlined and expanded adequately. The various special finance corporations are predominantly engaged in the *channelling* of resources to the private sector rather than in the *mobilisation* of resources from the public directly. In the nature of things this is inevitable. However, to the extent that the assistance by these corporations brings forth investible funds from other sources, their operations can be regarded as contributing to the mobilisation of savings indirectly; also, when these enterprises start functioning, there is scope for further saving effort through reinvestment of profits.

While probably no new financing agency is called for in the industrial sector, there is perhaps a case for giving some encouragement to the formation of investment trusts, especially of the 'unit' type, to mobilise the savings of small investors, who do not evince much interest in investment in shares. The most important incentive that can be given is in respect of taxation. These trusts, which must be prohibited from engaging in any business other than investment, should be exempted from payment of income and super taxes. At the same time, they must be compelled to distribute nearly all their profits. There should also be a ceiling on expenses of management, though they must be adequate to

draw people to start and manage the trusts. If this is done, the investors will not suffer reduction of income and at the same time Government revenues will not suffer. In the beginning, the initiative may have probably to come from official sources. The formation of a subsidiary jointly by the State Bank of India and the Life Insurance Corporation could be considered for the purpose. There is also need for adequate legal provisions to prevent managerial malpractices; perhaps, as in the U.S.A., separate legislation could be undertaken for the purpose.

The marked expansion in the new issue activity in recent years indicates the growing capacity of industry to raise resources from the public. Although not much statistical evidence can be adduced, it would appear that the habit of investment in shares and debentures is slowly spreading among the people. There is a great deal that the stock exchanges and investment brokers can do to accelerate this process. So far, the tendency appears to have been to sit in the ivory tower and expect people to rush to buy securities. Canvassing and publicity seem to be as important in promoting investment in shares and debentures as it is in the field of promotion of life insurance activity, for instance.

The integration of the organised and the unorganised sectors of the capital market on the one hand and the money and capital markets on the other is proceeding apace steadily. The extension of banking into the interior, both by the State Bank of India and other scheduled banks (the expansion of branches in the last five years being of the order of 40 per cent), the diversification of the functions of commercial banks, the rapid expansion of the co-operative credit organisation, the establishment of the various special financial corporations, the growth of the joint stock form of business, Government assistance to industry and the expanding role of the Reserve Bank in the sphere of rural credit and also industrial finance have all been contributing to this integration, which is of course a continuing process. The reservoir of investible funds is widening and from this common pool funds are being channelised into the various sectors, partly in accordance with such statutory requirements as exist and partly in accordance with the pattern of the return on investment. The general theory of investment is not to put all the eggs in one basket and so the rate of return is not uniform, depending upon a variety of factors, includ-

ing in particular liquidity and marketability of the investments. The above developments are making it possible for the investment activity in the private sector to record a steady rise.

As far as one can foresee, the Government will have to play the dominant role in the matter of mobilising resources, regardless of its undertaking directly a large share in investment activity. In a country like India, with low per capita income, taxation, small savings schemes and contractual forms of savings like provident funds and life insurance would have to play an important role; and since these modes of raising resources are directly in Government's hands, its role in savings mobilisation is substantial.

In considering problems of saving and investment, what Professor Lewis calls the 'behaviour' of Government naturally assumes considerable importance. Notwithstanding the talks of establishment of a socialist pattern of society and the various regulatory measures, as well as high taxation (though the 'highness' is partly apparent, if regard is had to the various rebates and allowances), investment in the private sector has recorded a substantial rise in recent years. Basically — and putting it crudelay — the 'bark' of the Government might be alarming at times but not the 'bite'. This is not to say that all the policies of Government in the economic sphere can be defended. In a developing economy, Government has to experiment in the spheres of taxation etc. but it should avoid fitful changes of policy. While sometimes the Government takes credit for the achievements of the private sector, now and then one also gathers the impression that Government is somewhat concerned at the rapid progress achieved by the private sector. If one recalls that the primary reason for the Government's taking initiative in the matter of economic development is the inadequacy of private enterprise, it is difficult to understand Government's concern at the progress which the private sector is making, especially when investment in the organised sector is subject to a large measure of regulation by Government. One of the most pertinent observations of Keynes was that the failure of capitalism was that it did not do enough rather than that it did too much. However, all said and done, the policies of Government have been pragmatic and the era of

planning which Government inaugurated in 1951 has provided plenty of stimulus to economic growth. The credit for arousing the country from economic stagnation should go largely to Government, which has done much to inculcate in the people a desire to make rapid economic progress and to demonstrate that such progress is possible.

The Government has undertaken much investment in the spheres of transport, irrigation and power, agriculture, education, public health and some basic industries. This is something which the Governments in all the developed countries have done and generally been doing. All this investment has been laying the solid foundation for an all-round growth of the economy. In other words, by and large, the public and private sectors have so far been largely complementary rather than competitive and there is no reason to think that this may not continue. Nor, broadly speaking, have the Government's regulatory measures so far been such as to discourage saving and investment, though occasionally pronouncements of Government spokesmen have served to create uncertainty and apprehension. Fixation of prices in respect of important commodities such as steel is done largely on the advice of an expert and quasi-independent body like the Tariff Commission, which takes into account the need for allowing a reasonable return on capital in order to ensure adequate growth. Likewise, in the areas where rent controls are prevalent, care is generally taken to fix a reasonable return on investment, though there is not much justification for the 'controlled' rents to remain largely unchanged in respect of prewar dwellings, resulting in indiscriminate subsidy to dwellers at the expense of the landlords and the general public in the long run. On the whole, however, price controls and the regulation of the direct return on capital should be kept down to the minimum. They tend to create rigidities and inequities, affect the marketability of assets and discourage the flow of savings into channels indicated by the preference of consumers. There is also need to avoid too detailed administrative regulations and formalities, which discourage enterprise.

Broadly, therefore, it may be stated that the general environment in the country and the machinery of the capital market are favourable for the mobilisation of saving. Actually, they are

inter-related. The growth and variety of the machinery for mobilisation of savings are themselves conditioned by the development of investment opportunities and the general willingness to save and entrust the savings to others for investment.

It was mentioned in the introductory chapter that in the last 6 - 7years the saving effort has on the whole been encouraging, though in the last three years or so there has been a significant gap between investment and saving, the higher investment being financed through larger foreign aid and utilisation of our foreign reserves. While the continuance of a significant volume of foreign aid is essential, there is need for stepping up significantly the saving-income ratio from the present level of around 8 per cent, in order to accomplish a bolder Third Plan. Rough estimates indicate that net investment (including investment in inventories) in the Second Plan may turn out to be about Rs. 6,500 crores and there appears to be a general feeling that the target of investment for the Third Plan has to be of the order of Rs. 10,000 crores. Therefore, there has to be a stepping up of the saving-income ratio to something like 11-12 per cent. This is not beyond achievement, but it requires concentrated effort on the part of Government and the general public.

As already mentioned, the problem of saving mobilisation is particularly difficult in respect of the relatively small income groups. Besides taxation, the Government has to make an effort to mobilise savings in other ways. Now and then, suggestions are made to introduce measures of compulsory saving, but by and large these are impracticable and raise difficulties of equity and administration. The one form of saving in which compulsion is prevalent is provident fund contributions; the provident fund scheme is being rapidly extended and there is further scope in this direction. There is considerable scope for the mobilisation of voluntary savings, through such media as life insurance and Government's small savings schemes. Here, there is scope for substantial improvement in the publicity and propaganda arrangements by the LIC and Government. The terms of the issue of the small savings instruments as well as life insurance policies also require to be made attractive and the procedures should be simplified. A lot has been accomplished in these directions in the last few years, but very much more requires to

be done. The striking success which the Bombay Government has achieved in the last two years in mobilising small savings demonstrates the powers of adequate publicity and campaigning in this connection.

The really difficult thing is the mobilisation of rural savings. As already mentioned, the co-operative organisation has done comparatively little to mobilise rural savings. Of course, to a considerable extent, this may be a reflection of the low quantum of rural savings. However, further organisational effort is called for to raise rural savings in monetary terms. It should be noted that even small increments of per capita saving will mean much in the aggregate. There is, of course, considerable scope for mobilisation of non-monetary savings, but this again is primarily a matter of organisation and the Community Development Programme should take care of this more intensively than at present. It is also necessary to stimulate consumption habit in the rural areas so that the people might bring forth larger output. It might appear that stimulating consumption would affect adversely the saving ability of the farmers, but this approach is static and ignores the beneficial effects of increased consumption upon productive efficiency and the desire to produce more. If consumption, including that of durable goods, is stimulated in the rural areas (for which purpose Government may set up shops and emporia and also organise mobile shops and exhibitions, which are now confined mostly to the big towns and cities), there would be partly a diversion of savings from investment in precious metals and partly additional savings would be created through increased output of agricultural commodities, for which there is sufficient scope. Contrary to the general view, the Indian rural population is casting off its traditional ways and it should respond favourably to the treatment of 'consumption'.

An important point for consideration in the task of more effective mobilisation of small savings, particularly in the rural areas, is whether the present level of interest rates offered on the small savings schemes are attractive. As mentioned in the previous chapter, the interest elasticity of saving is an unknown quantity, but it has not been proved that higher rates will not attract more savings. In the rural areas, where the

pattern of interest rates is high, the offer of higher rates on small savings schemes upto a limit, of say Rs. 2,000, is worth trying. A rate of something like $4\frac{1}{2}$ - 5 per cent on the postal savings deposits and something like $5\frac{1}{2}$ per cent on the various certificates (with some tightening of withdrawal facilities) should be in order; it may be noted that the current return on good preference and ordinary shares, is on an average 6 per cent tax free. The higher rates will of course have to be offered to all small investors, regardless of their residence, rural or urban. The attractive rates may also help to divert savings from gold and silver, to some extent. While on the subject of investment in bullion, it is for serious consideration whether we cannot have a law banning the private holding of gold above a certain limit. This would recognise that upto a small quantity there can be no objection to the ownership of gold for religious and other social purposes. It would appear that while the major part of the gold stocks are distributed over millions of small holders a not insignificant part of the stocks is accounted for by the relatively well-to-do classes, including those who indulge in tax evasion. It is a serious lacuna that there is no law to prevent a man from acquiring as much gold as he chooses to. This freedom of acquisition of gold does not prevail in many countries. The measure like the one suggested should not affect the vast masses of the population and might in fact help them. Such a measure will also lead to a further reduction of smuggling activity. There are of course many administrative difficulties, but the very presence of a law fixing an upper limit to holding would certainly have a deterring effect on excessive purchases. The adoption of a measure like this would of course require a great deal of political courage. Experience in other spheres of policy, such as for instance, family planning, has demonstrated that the Indian public can respond favourably to a sensible proposal.

Having said this, it should also be pointed out that purchase of gold and silver on a *small* scale is no crime against society; nor is it a sign of uncivilizedness. It is wrong to carry much too far the distinction between private holdings and official holdings of gold. The value of gold for monetary purposes cannot be entirely dissociated from its value as an article of

consumption, though it is hardly consumed away. In an extreme emergency, the private holdings should become available for meeting external payments deficit. In this connection, it is well to recognise that in the nineteen-thirties India exported about 40 million ounces of gold. The use of gold in the country is a multi-purpose device; while being indestructible and conferring enormous liquidity on the holder it also provides a lot of satisfaction to the wearer of the ornaments. Sometimes, foreigners seem to be of the view that the mobilisation of saving in India is largely dependent on our people's giving up the purchase of gold and silver. This is a superficial view of the situation. As was brought out in the earlier chapters, saving in other forms is fast growing. The fact that we have given up totally silver coinage, whereas several developed countries are adhering to it, indicates that we can take a rational view of things.

As already mentioned, a heavy responsibility lies on Government for mobilising domestic resources and for channelling them. On the positive side, three ways are open to Government to mobilise resources, namely, taxation, borrowing and deficit financing. On the negative side, economy in expenditure is also a way of conserving resources for investment. There appears to be a general impression that the non-development expenditure (even excluding defence expenditure) of Government is rising much more rapidly than it should. A developing economy requires austerity which should be practised by Government as much as by the public. A poor country cannot afford to indulge in the luxury of what has now become famous as Parkinson's Law, either in the public sector or the private sector.

Coming to the positive aspects of mobilisation, there is little doubt that the maximum emphasis has to be placed on taxation, including an appropriate pricing policy for the products and services provided by Government enterprises. It is sometimes asked, especially with reference to the excise duty, whether there is any difference at all between taxation and deficit financing. In this connection, it has to be borne in mind that the fundamental difference between the two is that in the case of taxation the sacrifice of current consumption is done

in a deliberate and planned manner, causing the least inequity, whereas deficit financing is a disorderly way of obtaining that sacrifice. In resorting to taxation, there could be, however, a conflict of interests between maximum growth and social justice. Since the relatively large income classes normally save the greater part of their income, while the smaller income people consume away most of it, purely from the point of view of promoting saving and investment, the rich have to be taxed rather lightly and the smaller income people rather heavily. But that would conflict with the ends of social justice, which is a very fundamental objective of our Constitution. On the whole, the Government has successfully endeavoured to tax people at all income levels, though one gathers the impression that the agricultural sector is not being taxed adequately.

It is difficult to say if high taxation affects the *wilingness* to save and invest except perhaps at very high income brackets, but it certainly affects the *ability* to save, of individuals as well as the corporate enterprises. In fact, it might stimulate the willingness to save. The general effect of high taxation has been to render it extremely difficult for proprietary and partnership enterprises to grow, without much of loan assistance. This has probably contributed both to gradual expansion of the corporate enterprises and for transfer of some resources back from the public to the private sector, for development purposes. Also, channelling of funds through institutions is steadily expanding in relation to other sources. In considering changes in taxation for a bolder Third Plan, this aspect of ensuring adequacy of resources for investment, especially for corporate enterprises, has to be borne in mind. This is of course basically related to the relative share of the public and private sectors in the total projected investment for the whole economy.

Borrowing operations naturally have a second place. It is important to remember that not all borrowing is non-inflationary. As a matter of fact, in some of the Western countries, particularly in the United States, any borrowing is regarded as constituting a budgetary deficit, though certain types of borrowing are inflationary and certain other types non-inflationary. A large marketable public debt is regarded as inherently inflationary as it contributes to the liquidity of the economy. This is

particularly so in regard to the contribution of commercial banks to the Government borrowing programme, since generally it is inflationary in character. There is, therefore, the utmost need to encourage small savings and purchase of Government securities by non-bank investors.

As regards the role of deficit financing, there appears to be general agreement that upto a limited extent it is useful and necessary in mobilising resources and stepping up the tempo of investment activity, though nobody has been able to say precisely as to what is meant by "to a limited extent" or "on a modest scale." However, in practice it is not very difficult to say when inflation has been excessive. While not all deficit financing need lead to inflation, in practice they are synonyms in underdeveloped economies, since generally, the point of inflation is reached pretty soon. In this connection, it is not much profitable to refer to the experience of the developed countries, many of which have had serious inflation in the early stages of development. The political, social, institutional and the international economic environment now prevalent in India, for instance, is totally different from what prevailed 100 to 150 years ago in the developed countries. In those days, the sufferings of the large masses of people, as a consequence of inflation, went largely unheeded. Labour was either not organised at all or ill-organised. Further, the economies were free so that there was quick response to the stimulus of inflation and the process of growth was achieved in a rather short time. Our conditions are dissimilar.

In the under-developed countries there is not much of excess capacity and in general there are inelasticities of various sorts, so that response to the stimulus of inflation in the form of larger production is rather poor. Also, the attitude of organised labour and even salaried employees is very important; if, as in our country at present, there is very little toleration of a rise in prices and cost of living, leading to widespread demands for wage and salary adjustments, deficit financing is not of much avail. There is also the question of the effect on voluntary savings of inflationary trends. Here one has to make a distinction between *willingness* and *ability* to save. It is hard to say that inflation will necessarily lead to diminished willingness to save, especially if it is not expected to be a prolonged one. It could conceivably lead

to greater saving effort insofar as people may like to be sure of a certain minimum real purchasing power when the savings have to be drawn upon. But there is little doubt that for most sections of the community, except the entrepreneurial and the trading classes, the ability to save will be seriously affected by inflation. It is difficult to say whether, in the long run, aggregate saving will in fact record a significant rise as compared to the magnitude of deficit financing. Also, the likelihood is there of saving taking unproductive forms such as building up of inventories. Large-scale deficit financing will also lead to serious balance of payments difficulties and devices like exchange control are of limited efficacy in maintaining exchange stability. On the whole, therefore, it is desirable to restrict resort to deficit financing and to see that it is incurred for productive purposes only, particularly for investment with a short gestation period. Also, there is much merit in the suggestion that if inflation is to be used for capital formation, it should be done intermittently rather than continuously, so that speculative forces may be held in check by a jolt now and then, and the favourable stimuli of inflation may be fully absorbed.

In this connection, the observations of the Federal Reserve Bank of New York, based on a study of real output and price trends in sixteen under-developed countries of Asia and Latin America, will be read with interest.*

> The principal generalization they (i.e. the data) suggest is that the countries where prices advanced moderately or not at all from 1950 to 1957 experienced rates of economic expansion which by and large were steady and which clustered around an average of close to 6 per cent annually. In contrast, the countries where sustained inflationary pressures developed during this period have shown widely varying and somewhat sporadic growth; the average rates of growth have ranged from less than 1 to more than 7 per cent, with an average of about 4 per cent for the whole group.
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> Economic development through inflation has repeatedly turned out to be a chimera. It is unacceptable as a conscious economic policy. Price stability, as the record shows, is not a luxury that only a few selected countries can afford; nor is it an unattainable goal in a country attempting to achieve a breakthrough that will launch the economy on the road to cumulative economic growth. If it were, there could be no balanced or lasting economic development.

* *Monthly Review,* August 1959.

These observations, coming as they do from a central banking institution, may perhaps be regarded as over-stating the case for financial orthodoxy but they serve to indicate that deficit financing has to be employed judiciously. It might be considered that, as compared to under-developed countries generally, India is better situated to benefit from the expedient of deficit financing. For, her economy is now rather diversified; there is a regulatory apparatus to prevent, to a fair extent, distortions in investment, and the tax machinery is well developed to withdraw part of the new incomes generated. What is the experience of the Second Five Year Plan, which commenced on April 1, 1956? In the first 4 years, the Plan outlay in the public sector is estimated at Rs. 3500 crores (the investment content of which should be of the order of Rs. 2800 crores); in the same period, deficit financing is likely to amount to Rs. 1075 crores, or roughly 30 per cent of the Plan outlay. A good part of this is not deficit financing in the sense of uncovered domestic expenditure; the deficit has also been incurred to cover foreign expenditure and there has been a simultaneous reduction in foreign reserves, which have also been drawn upon for financing excess of imports on private account. Thus, in the above 4-year period, the decline in foreign reserves may be put at a little over Rs. 600 crores (including the purchase of dollars from the I.M.F.) or almost 60 per cent of the budgetary deficit. Even so, commodity prices have been rising more or less continuously, the net rise in the general index of wholesale prices in the 4 years being of the order of 20 per cent. This may not be regarded as unsatisfactory as compared to the performance of under-developed countries generally and perhaps of some developed countries too. However, particularly in view of the rather small size of our foreign exchange reserves (as of mid-February 1960, the Reserve Bank's holdings of foreign reserves amounted to Rs. 203 crores, excluding holdings of gold of the value of Rs. 118 crores), we have to proceed with circumspection in the matter of resorting to deficit financing. In this connection, it is gratifying to learn that the estimated deficit financing for the year 1960-61 is lower at Rs. 153 crores as compared to Rs. 190 crores in 1959-60 and the high of almost Rs. 500 crores in the year 1957-58. In this matter,

as in many others, our approach has to be pragmatic. We are not yet in a position to gauge precisely the potentialities of our economy and the use of deficit financing has, therefore, to be continuously adapted to the situation as it develops. It is doubtful if any cut and dry formula or model can be usefully evolved for this purpose. In this matter a lot depends upon human responses and attitudes which it is not easy to predict. Incidentally, the deficit financing figures also cover the working capital requirements of the public sector enterprises. In this connection, it would appear to be desirable for public industrial undertakings to utilise the commercial banks, say the State Banks in particular, for purposes of obtaining credit for working capital and for general banking purposes.

It is also necessary to point out that deficit financing is not confined to the public sector. Private sector too resorts to it, through borrowing from the banking system. The monetary authorities have to take appropriate measures to regulate the expansion of bank credit, including access of the banks to the central bank, in a manner that will contribute to general monetary stability, though in the context of Indian conditions, there is not much scope for the multiple creation of credit by banks. It would appear that in the Second Five Year Plan so far, the expansion of bank credit has on the whole been modest; in the case of scheduled banks (i.e. member banks of the central banking system) the net expansion of credit went on declining from Rs. 139 crores in 1956-57 to Rs. 63 crores in 1957-58 and Rs. 51 crores in 1958-59. In the year 1959-60 it looks as if the expansion would be larger, reflecting mainly the sharp recovery in the growth of industrial output. As of mid-February 1960, the *outstanding* credit extended by the scheduled banks stood at Rs. 1053 crores, representing an *increase* of about Rs. 100 crores over a year. In this 4-year period the expansion of credit has been less than the growth of time deposits, even if P. L. 480 deposits are excluded.

The Reserve Bank of India has been alive to the need for regulating the expansion of credit to match the legitimate requirements of a growing economy. The Bank has repeatedly stated that its policy is one of 'controlled expansion'. In the period

March 1956-May 1957 or roughly the first year of the Second Plan, the Bank raised its lending rates to scheduled banks by $\frac{1}{2}$-1 per cent. It has also been making sales of securities. Further, the Bank has taken measures of selective credit control in respect of advances against foodgrains, sugar and oilseeds; the Bank's view, however, is that selective controls are only of marginal significance.

It may be hoped that in the years to come monetary weapons will be fully pressed into service. It is hardly necessary to emphasise the need for a proper co-ordination of monetary and fiscal policies, though there is little doubt that in the task of achieving growth with stability the role of monetary policy is a comparatively minor one. All the same, the fullest use should be made of monetary instruments, the efficacy of which is perhaps underrated. The organised and the unorganised sectors of the money and capital markets are not so unconnected as to render changes in monetary policy ineffective over a wide area of the economy. There has been a steadily growing dependence on the Reserve Bank for accommodation by commercial and co-operative banks as also some of the finance corporations. Surely, changes in the cost and availability of credit and in capital values have important effects on the economy. If we believe in the objective of democratic planning, we have to utilise, to an important extent, the market mechanism rather than too many detailed regulations, and monetary instruments can make a useful contribution towards this end. Paradoxical as it may seem, to the extent that there is a substantial resort to deficit financing, there is greater need for vigilance on the part of the central bank to immobilise as much of the additional bank reserves as possible and to restrain resort by banks to the central bank for accommodation.

In the under-developed countries, the role of the central bank is not merely regulatory; it has also a positive or promotional aspect. The central bank has to play an important role in creating an adequate machinery of credit for financing the growth of the economy. At least in the early stages, the credit system has also to be given some sustenance by the central bank. In this respect the Reserve Bank of India has done much good work,

particularly in the field of rural credit. It has also taken interest in the creation of the institutional machinery for the provision of industrial finance. The expansion of banking facilities is yet another field in which some good work has been done by the Bank, but there is obviously scope for much further progress in these directions in the years to come.

It is hardly necessary to emphasise that even with the best of efforts to mobilise domestic resources, a substantial amount of foreign aid is required for the development of the economy. In the Second Plan period, the quantum of foreign aid has been quite substantial. The total amount of authorised assistance in the Second Plan, till the end of 1959, was Rs. 1280 crores, of which about Rs. 850 crores was utilised by the end of September 1959. It is important that foreign aid, especially the loan part, is used wisely in order to promote capital formation rather than consumption. It would appear that something like 35 per cent of the aid utilised in the Second Plan has been for purposes of importing articles like foodgrains, cotton, tobacco, etc. It is true that the counterpart funds of these imports provide the resources for capital formation, but even so it is desirable to keep down the imports of such agricultural commodities when there has all along been considerable scope for larger output of these within the country. It is hard to realise that in the last 9 years or so we have imported more than Rs. 1,000 crores worth of foodgrains. It is true that as a country's economy gets diversified, with the growth of manufactures, dependence on imports of foodgrains etc. may tend to increase. But in present Indian conditions, when we can raise our output of foodgrains and industrial raw materials, food imports of the above order cannot be justified, particularly financed by loans, leaving as they do a heavy burden of interest and amortisation charges.

Inevitably, the major share of foreign aid will go to projects in the public sector. Again, the major portion of the aid is likely to come from foreign governments and international institutions, rather than from private sources. During the four years 1954 through 1957, the *gross* inflow of private capital into India was only of the order of Rs. 100 crores, of which retained earnings of foreign enterprises operating in India were Rs. 53 crores. The signi-

ficant thing is that the new capital coming into the country is steadily rising, from an average of Rs. 9 crores in 1954-55 to Rs. 16 crores in 1957. *Net* inflow (i.e. deducting the outflow) during this period was Rs. 74 crores, of which the petroleum industry alone accounted for Rs. 57 crores. During the last three years or so, deferred credit would appear to have been rather an important source of foreign private capital. From the stray data that are available, it should not be surprising if the amount of deferred credit received ran into Rs. 40 - 50 crores during the last three years. Recently there has occurred a perceptible improvement in the climate for the flow of foreign private capital into India. There is increasing evidence of willingness for foreign capital to come into India in collaboration with the Indian capital.

Economic progress is, in the ultimate analysis, dependent upon two factors, namely, enterprise and thrift and the mere establishment of institutional facilities will not bring forth additional resources. What is required is the development of an attitude of effort and sacrifice, bearing in mind the long-term interests of the economy. The development of such an attitude is necessarily a time consuming process but the comforting thing is that progress in this direction is being made. "What is in doubt is not whether it is economically possible to step up the rate of capital formation, but whether it is politically possible to do so within the democratic framework".* In the long run, Governments will lose confidence by doing less in the matter of mobilisation and investment rather than by doing more.

As mentioned at the beginning of this book, there appears to be little doubt that notwithstanding the Indian Government's declared objective of the establishment of a socialist pattern of society, at least for many years to come the private sector will continue to have considerable scope for expansion. In fact, it is not beyond the realm of probability that a time may come when the Government may hand back to private enterprise the management of many of the public enterprises, being content to exercise a broad measure of regulation to promote expansion, efficiency and social justice. Or there could also be joint ventures, on a large scale, with Government and the private sector collaborating. The forms of social and economic organisation will un-

* W. A. Lewis, *The Theory of Economic Growth.*

doubtedly change largely in response to the new patterns of scientific achievements, but the necessity for saving and capital formation will continue for all time. While as a result of progress of science the supply of goods and services would increase, the demand for these would also increase. This is the eternal economic problem. Subject to this basic postulate, what is required is a continuous adaptation of thinking and techniques to new situations. This is as true in the sphere of capital market as in the field of economic and social organisation in general.

As Keynes said, "it is ideas, not vested interests, which are dangerous for good or evil". Whether banks should engage only in short-term lending or go into the sphere of medium and long-term lending, whether the financial corporations should give only loan assistance or also participate in equity financing, whether the solution to the rural problem lies in developing only the co-operative system or other solutions are possible etc. etc. are issues on which it is not necessary to have dogmatic views, having the air of eternal validity. It should also be mentioned that the economic system, like the human body, has checks and balances and can get on well without much of doctoring. Taking the analogy further, while the human anatomy and physiology are the same in fundamentals, there are infinite variations in detail as between one individual and another. Likewise, while the factors governing the growth of economies are broadly uniform, there is scope for many variations in detail in respect of targets, techniques, time schedules and results, from country to country. As the saying goes, necessity is the mother of invention. So long as people are seized with the desire to achieve material advancement and to obtain economic security, as our people seem to be, all kinds of devices and expedients will be developed to find the resources for development. It is probably correct to say that the 'religious' attitude or the 'spiritual' nature of the Indian people is not standing much in the way of economic growth. Rather, we now seem to be in the transitional phase when we are eager to enjoy material prosperity but are not yet prepared to put in adequate effort for the purpose. There is, however, ground for optimism.

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